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BUSINESS TRAINING
&
CORRESPONDENCE

BY

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Thoroughly Revised & Enlarged

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PREFACE

A word is perhaps needed in justification of the author's attempt in bringing out this manual Having been connected with the teaching of this subject for over a decade and having been confronted with certain real difficulties of his pupils, this little volume is the outcome of the author's sincere desire to render the subject more easily graspable by the younger students, and how far he has succeeded in his efforts towards this aim wiser and abler heads alone will tell

This book should prove of immense help also to business men who have adopted, or intend adopting, modern methods of conducting their trade activities

S R GUPTA.

Khurja, September, 1934

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PREFACE TO THE SECOND EDITION

In bringing out the second edition of this manual no pains have been spared to render it all the more useful It has been thoroughly revised, enlarged and brought upto date Some of the chapters, for instance on '*Time and Labour Saving Appliances*,' '*Home Trade*,' '*Agents and Middlemen*,' have been re written, and considerable additions have been made in regard to other topics The book in the present form would, it is sincerely hoped, meet in full the requirements of the students of this subject, in nearly all the provinces of India

The author takes this opportunity of thanking all his friends and colleagues for their valuable suggestions so ungrudgingly offered for the betterment of this book

May, 1936 THE AUTHOR

Preface to the Third Edition

In the present edition of this book the chapters on "Postal Information"—both Inland and Foreign have been revised and several new topics introduced with a view to incorporate the latest Postal and Telegraphic regulations Considerable matter has also been added to information regarding the "Air-mail" services, the Telegrams and Telephones.

March, 1937. THE AUTHOR

Preface to the Fourth Edition

Once again this book has been thoroughly revised and enlarged Much useful additions have been made to Chapters on Filing Systems and Bills of Exchange. Secondly, as a result of suggestions received, the **"Correspondence" Section** is now given the first place.

In its present form this book is sure to meet the special requirements of the Intermediate Course for the first year, and the author is glad to record with satisfaction the popular reception this book has already received.

July, 1938 THE AUTHOR

Preface to the Fifth Edition

In this fresh edition of the book the 'Postal Information' has been brought up-to-date. It has been carefully revised and also re-arranged in a way. Some useful matter has been added to the chapters on Bills of Exchange and Promissory Notes, with a view to render the book all the more helpful to the Intermediate students.

August, 1940. THE AUTHOR.

A word as to the Usefulness of the Subject

It is a fact of common knowledge that in modern times trade industry, and commerce of the world have much developed Every country, large or small, and situated anywhere on the globe, must partake of this world business Every *province or state* within a country is now a days an active centre of some sort of manufacture or business pursuit

The enormous volume of world wide commerce naturally involves monetary transactions worth crores of rupees, and whole armies of businessmen, bankers, accountants, clerks, salesmen, and the like are engaged in its various operations

Alongside this huge development of industry and commerce a need has been felt that our youngmen, if they are to become successful leaders of business, should receive systematic training in most modern **business methods** in the *educational institutions*

This sort of training has had valuable results in other countries In general, it enables people to fit *in more effectively and co-operate more intelligently* in the larger organisations which are becoming so prominent a feature of modern industry and commerce Persons, properly trained, not only adopt the best method of doing the work, but also understand the purpose and scope of the occupations they engage in As a result, young men realise the significance of their task, acquire habits of industry and grudge no efforts for the success of their business

India has already embarked on her mission of industrial and commercial regeneration of the people and stands in need of *specially trained men of business*. A good knowledge of business affairs will enable us to take real interest in work, lessen drudgery by following up to-date methods, and help much in the advancement of trade and industry *of the country*. Hence the study of a suitable course of '**Business Training**' is of vital importance to us all.

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BUSINESS CORRESPONDENCE

CHAPTER I

Introduction

The art of writing letters is called *Correspondence*. It is with the use of letters that persons living at a distance can exchange their thoughts, know the welfare of each other, and even settle many a matter which would otherwise have required personal meeting Modern business in every part of the world is carried on mainly through the medium of letters The routine in Government and other public offices is conducted by means of letters passing from one department to another

To be able to write good letters it is necessary that the writer should have :—

(1) A complete information of the subject matter or topic to be dealt with

(2) He must possess a good working knowledge of the language in which the letter is desired to be expressed

Letters are generally written in English, since it is the language most widely used throughout the British Empire and in other parts of the world To express one's ideas correctly in English, it is imperative that the writer should be thoroughly conversant with the ordinary rules of Grammar and Composition

(3) He should know the correct meaning and use of technical words and phrases relative to a particular subject, and

(4) He must be able to adapt the style of writing to the different requirements of correspondence, that is, he should choose the style or mode of writing a letter according to its nature and use As will be shortly explained, the styles of private letters, business letters, and official drafts, all differ from one another

In short the person who has to write letters must be well educated, well-informed and resourceful He must be able to express himself clearly as well as *correctly*

Branches of Correspondence :—*The subject of* Correspondence is usually divided into three main branches —

(1) *Private or Personal* —All letters which are written between relations, friends and acquaintances come within this branch Post cards or *octavo note papers* (8″×5½″) are generally used for such letters.

(2) *Business or Commercial* —This branch includes all those letters which pass between merchants, manufacturers, bankers, etc , in connection with business matters Such letters are mostly written on *quarto* (8″×10½″) or *business letter papers*

(3) *Official* :—Within this branch *come all communications* (letters, memos , etc) passing between the offices of Govt. Departments, whether Local or Imperial They relate to the various matters of the *administration of a country and are written* mostly on the *Foolscap-size papers* (8″×13″).

Business Correspondence

'*Letters are the soul of business*' , without letters modern methods of business could never have achieved even half the success they have During the past century, *manufactures, industry, trade and* transport have much progressed, and along with them has increased the use of business correspondence In its turn this correspondence has greatly helped the growth of business and trade In fact, commerce *is both the cause and effect of correspondence*

Qualities of a Business Letter—A good commercial letter should display 7 C's, that is, it should have—

(1) Clean and neat appearance,
(2) Correct Grammar,

(3) Clear meaning,

(4) Concise form,

(5) Complete statement,

(6) Convincing facts, and

(7) Courteous style

Neat appearance —A business letter should be written legibly or typed on a neat and fine sheet of paper This will do much in producing a good effect on the recipient of the letter He is sure to form a respectful opinion about you and your business When a letter is type written it should be free from marks of erasing corrections, spots of ribbon ink, etc Folding, stamping, and addressing should all be done in a neat and nice manner

Clear and Correct Meaning —The letter should be correct in Grammar and clear in sense For example, note the difference between the meanings of the following sentences . –

(1) Please send the Goods per V P P, only, by the 6th inst.'

(2) 'Please send the Goods per V P P, only by the 6th inst

(3) Please send only the Goods per V P P, by the 6th inst

(4) 'Please only send the Goods per V P P., by the 6th inst

The change in the place of the comma alone has altered the meaning In the first sentence the stress is on the method of sending the goods, that is by 'V P P, while in the second, stress is laid on time of sending the goods that is, 6th of the same month In other two sentences the stress is on 'Goods' and 'send' respectively Therefore, special attention should be paid to ordinary rules of punctuation, spelling, place of words etc Amounts must be very carefully written, both in words and in figures

where necessary Spellings of the names of persons and places must be correct

Concise yet Complete Statement—In business 'Time is money' hence unnecessarily long letters waste time both of the writer and the reader Be frank and write just to the point *Do not beat about the bush* as they say Use only as many words to express your sense as are absolutely necessary **But at the same time while you try to be short do not be incomplete not even in telegrams**

It is *altogether un necessary to use idioms or* write poetical English in business letters On the other hand the meaning and use of certain phrases terms and abbreviations occuring in everday business language must be thoroughly understood

Courteous Manner—Be always polite in writing these letters Do not write anything which may *show anger or disrespect on your part The best way of avoiding this is never to write when one is angry.* Even when you are expressing your opinion on a disputed point be courteous At the same time, however do not be begging that is do not lower down your position

Convincing Facts—*In letters written specially for* soliciting new business or increasing the old it is of utmost importance that your arguments must convince the addressee of all that you say You have to win the confidence of your customer hence *never exaggerate things*

Give reasons for your arguments and be forceful yet straight forward

Parts of a Business Letter

A business letter consists of six parts —

The Heading—It includes the place of the writer and the date on which the letter is written These occupy the *top right hand corner of the sheet* Very

often the names of business firms are printed in elaborate designs and colours in the centre of the sheet, together with the place-name followed by a line for date And the "*Telegraphic Address*," "*the Telephone No* , *the name of the* "*Code*" used and the names of *branches*, if any, are also given on the left top corner

If the place-name is not long or consists of only one word, *e g* , where there is no street name or number the date may be written in the same line, separated by a comma but, generally, date is written on the second line When the number of building or the name of street, road, or bazar has to be written, it should be placed in first line , and the name of place, followed by the date, on the next line The number should have a comma after it

The correct order of date is —date, month and year, *for example 8th, June, 1936* It may be written as June 8, 1936, but never as 8—6—36 The names of some of the months are contracted thus —Jan , Feb , Mar , Apl Aug , Sept , Oct , Nov , Dec

Examples —

(i) Delhi 1st Jan , 1936

(ii) Sadar Bazar,
Delhi, Jan 1, 1936

(iii) 31, Sadar Bazar,
Delhi, 2nd July, 1936

Reference Number:—Sometimes a number is given to a letter for the sake of reference It may either be a pure serial number or may have an alphabet and a number, such as A/35, which means that this letter has been copied in 'A' Letters Copy Book on page 35 The Reference Number should always be quoted in the reply

2 **The Inside Address**:—This consists of the name and occupation (or title, if any) of the addressee

and also his place of business It begins from the left hand margin one or two lines below the Heading The lines of this address may be arranged diagonally in a *series of steps* or the whole may be beautifully centred, or each one of the lines may begin just at the margin The first two forms are known as the English styles and the third one as the American. The English style has a pleasing look, while the American is time-saving and easier for the typist

Examples

(i) Mr. Shanker Swarup Agarwal,
Cap Merchant,
Hazratganj,
Aligarh

(ii) Mr Shanker Swarup Agarwal,
Cap merchant,
Hazratganj,
Aligarh

(iii) Mr Shanker Swarup Agarwal,
Cap Merchant,
Hazratganj
Aligarh

A comma should be placed after each line and a full stop after the last

The Inside Address is useful in the following respects —

(1) In big business houses the letter is typed (or written) by one person and it is despatched by another So the despatcher can copy the address on the envelopes from the letters.

(2) If the letter is wrongly addressed or reaches a wrong address, it can be forwarded to the right addressee

(3) The writer of the letter cannot afterwards say that it was not addressed to the person or firm *that received it.*

Therefore, this Inside Address is not necessary when writing on a post card, where the name of the addressee alone may be given.

Forms of Address—In business letters as a matter of courtesy the word '**Mr**' (short form of French word '*Monsieur*') is placed before the name of a **single** trader as —

Mr Radhey Charan Gupta,
Bookseller,
Khurja

The word '**Messrs.** (abbreviation of French '*Messieurs*') is placed before a partnership, a firm, or a company having a *personal name*, as —

Messrs Radhey Charan and Uma Charan.

Messrs Ram Dayal & Sons.

Messrs Ram Dayal & Bros

Messrs Ram Dayal & Co

Messrs Gupta Bros & Co

If the name is *impersonal* then '**The**' should be used, as—

The Friends & Co

The National Stores Ltd

The Remington Typewriter Co

The Modern Book Depot

In case of female names write '**Mrs.**' (pronounced '*misiz*') for a married lady, as .—

Mrs. Raghubir Singh,
Lady Doctor,
Poona

'**Miss**' *is used for an unmarried lady, as* :—

Miss Parbati Debi,
Lady Physician,
Allahabad

The Plural of 'Miss' is 'Misses'

'Mesdames (pron *Madams*) should be used for a name consisting of more than one lady as —

Mesdames Laxmi Bai & Co ,
Drapers and Tailors
Bombay

'Esq (short form of *Esquire*) is used only after the name of a single person of some position or a graduate of a University as —

(1) Bhagwan Chandra Sharma, Esq
Honorary Magistrate,

(2) Brahma Swarup Esq., M A ,
Principal

Note — *Mr* and *Esq* are never used together it is wrong to write Mr Bhagwan Das Esq

University Degrees *and letters denoting designation* in service are placed after 'Esq ,' for Example —

(1) Laxmi Narain Mathur, Esq , B A., L T

(2) Haidar Hussain, Esq , I E S

For a **Doctor of Medicine** write thus —

Dr Makkan Lal Gupta, or

Makkan Lal Gupta, Esq , M B , B S

that is "**Dr.**" and Medical degrees should not be used together

Titles of honour and rank, such as—

(*a*) Sir, Hon. (Hon ble) *Rt* , Hon , etc ,

(*b*) Capt , Major , Col , Gen , etc ,

(*c*) Rev , Rt Rev , Canon etc ,

are placed before the name *But then 'Mr' or 'Esq'* is not used

Note — As regards '*Rev*' if it is to be placed before the surname only then '*Mr*' should also be put as—

Rev Mr Smith (The full name being James Smith)
Else, **Rev** James Smith

Titles of honour for the Indians such as '*Raja* *Rai Bahadur* *Rai Sahib* *Khan Bahadur* *Khan Sahib* *Divan Bahadur*, '*Divan Sahib* *Sardar Sahib* *Sirdar Bahadur* etc etc are placed either before or after the name

When these title are used before the name words like **Pt** (Pandit) **L** (Lala) **Th** (Thakur) **'Ch** (Chaudhary) **B** (Babu) **M** (Munshi) **Md** (Mohammad) should be placed between the title and the name without using '*Mr*' or *Esq* for example

Rai Bahadur B Ram Swarup

Khan Sahib Md Malakdad Khan

3 **The Salutation** —The form of Salutation varies according to the personal relations between the parties to a business letter as well as on the particular occasion of each letter As a general rule **Dear Sir** *is used for a business man* **Madam** or **'Dear Madam** for a business lady and **Dear Sirs** or **'Gentlemen** for a firm or company Sirs Gentleman Dear Gentleman and Dear Gentlemen should not be written

The Salutation *begins from the margin below the* Inside Address and a comma is put after it

4 **The Message or Body** —This part of a letter is very important as it deals with the subject matter itself It should be divided into paragraphs according to the importance and number of topics discussed in the letter and each para should begin about half an inch away *from the margin*

In the beginning it is usual to refer to the letter under reply in some such phrase as—

In reply to your letter No dated

'With reference to your invoice

'Referring to our order of yesterday

Following the old custom the last para sometimes ends with a phrase such as —

Hoping to receive your valuable order

'Thanking you in anticipation

'*Awaiting the favour of your reply*
'*Apologising for the mistake*

But these phrases both in the beginning and in the end are not much used now in modern letters

Note very carefully the use of the following contractions in referring to the *dates of letters* :—

Inst (instant)	=	present month,
Ult (Ultimo)	=	past month,
Prox (proximo)	=	coming month,
Idem	=	the same month

Suppose you are writing a letter on the 20th May, 1938, then in referring to the various dates given below on the left you will write as on the right —

15th May	15th inst
30th April	30th ult
3rd June, and 10th June	3rd prox., and 10th idem

Subject Heading :—In rather long letters the subject matter of the letter is sometimes indicated in the centre before the body, as—*Re Damage of Goods.* It helps to understand the whole letter at a glance. Insurance companies always give the policy number in the centre of the letter *e g*, *Re* Policy No. 59138.

5 **The Subscription or Complimentary Close** :— *These are words showing respect or feelings of* regard towards the addressee, and occupy a place to the right below the body of the letter The *Complimentary* Close should agree with the form chosen for 'salutation'. The usual forms of subscription in business letters are—

'*Yours faithfully*' or '*Faithfully yours*,' and they agree with '*Dear Sir*' and '*Dear Sirs*' or '*Gentlemen*.'

'*Yours truly*' may be used when the relations are well established, as those of friends

'*Yours respectfully* and '*Yours obediently*' are sometimes written for new customers and strangers, and also when business relations are on the point of breaking (see 4th Reminder letter) In business letters, *Sincerely*' '*Affectionately* and '*Obedient servant*' are **never** used

When the last para in the body of a letter ends with a participial phrase (already explained), the words '*I am*' or '*I remain*, and '*We are*, or '*We remain*' should be written before the subscription, and also the form of salutation used should be repeated, as for example —

Awaiting to receive a trial order,

I am, (or I remain)	We are, (or We remain)
Dear Sirs,	Gentlemen,
Yours faithfully,	*Faithfully yours*,

6. **Signature** :—It follows the *subscription Since* the person signing a letter is held responsible for all that is written in it a letter without the name of the writer or of the firm or company is quite useless

Precautions :—*(a) The signature is always made with the pen*, even when letters are typed. The name of the firm or company is sometimes impressed with a rubber stamp, and the signature of the responsible person is given in ink

(*b*) Care should be taken that a signature is always in the same spellings and style This is very important in valuable documents, *e g*, cheques, bills, etc

(*c*) If at the end of a page there is not enough space for the complimentary close and signature, *do not write them alone on the next sheet, but carry over some words of the body of the letter to the next sheet and then finish with the complimentary close and signature.*

How to Sign :—In a partnership each member signs the name of the firm and not his own name.

Suppose four persons—Ram Lal, Shiam Lal, Mohan Lal and Sohan Lal—carry on a business under the name of '*Ram Lal & Co*,' then each one of them should sign *Ram Lal & Co* ' in his own handwriting.

In companies and Banks some responsible person such as the Manager, or the Secretary, signs on behalf of the Company, giving his official designation, for example—

(1) For the Lalimli Woollen Mills, Ltd.,
H Higgins,
Manager

(2) For The Imperial Bank of India,
W Wilson,
Director.

Per Procurationem (per pro., p pro , or p p) When a person is specially authorised by means of a legal document called Power-of-Attorney (P/A) to sign on behalf of a firm or Company he is said to sign 'by procuration'; as—

p p Thacker Spink & Co ,
John Brown,
Secretary.

If a person is not so authorised he should use the word '*for*', '*per*' or '*p.*', **but not** '*p p.*', '*per pro.*' or '*p. pro.*'

Note.—The term '*Ld.*' or '*Ltd.*' (Limited) is written after the names of Registered Companies and Partnerships. *It means that the liability of the members or partners is limited.*

Enclosures :—When any business document—Invoice, Cheque, Bill, Hundi, Receipt, etc.—is enclosed with a letter, the fact is indicated at the bottom left hand corner, by giving the name or number (or both) of the document, as—

(1) Enclos. 3
(2) Cheques 2.

This is useful in letting the addressee know the exact nature or number of the documents sent along with a letter.

It also helps the despatch clerk in placing right enclosures inside right envelopes.

Some people indicate an enclosure by putting a small coloured label

Initials of the Typist—Where two or more Typists work in an office each one has to give the initials of his (or her) name in the lower left hand corner of the margin or just below the space for 'enclosures' Sometimes the initials of the person who dictated the letter are also added, thus :—

"P B S' or 'P B S/T N G"

Similarly in invoices, statements of accounts, etc, the initials of the person who prepared them and of the one who checked them are also shown This precaution is meant to hold a person responsible for his own work, and thus to secure more accurate and thorough work

A Post Script (*P S*)—After a letter has been written and signed and something more has to be added, it is put below the signature preceded by "P S." But it is not a good practice

Memorandum Forms—Half sheets of quarto paper, with printed Headings, and blank spaces for the date, name and address of the addressee, are sometimes used for writing short notes, and unimportant messages They are initialled generally by the clerk

The following is a specimen form of a memorandum :—

Memo.

April 5, 1936.

From	To
Sharma Bros, & Co, Shahganj, ALIGARH	Messrs. Gupta Bros & Co, Publishers, KHURJA (U P)

Please send as early as possible the books ordered in our letter of the 1st instant, and oblige.

P. L. SHARMA.

Diagram showing Arrangement of Commercial Letters

(Printed Heading)

Telegraphic Address (Place ——

Telephone No (Date) —— 193

Code used ——

(Reference No) ——

(Inside Address)

—— (Salutation)

(Body of the letter) ——

Margin ——

(2nd para) ——

(3rd para) ——

(Subscription) ——

(Signature) ——

Enclo

he has to read the whole correspondence and also he is supposed to know all the necessary Government Rules and Standing Orders as well as similar previous cases The file of letters is then sent to the Officer for necessary orders

8 Drafting—*After the Officer's orders*, the file comes back to the office for drafting the reply The draft is a rough copy of the reply based on the Notes *and the orders of the officer It contains usually* only the body of the letter, and most of the words are abbreviated

9 Fair-Copying—When the draft has been approved by the Officer it is then handed to the Typist for Fair Copying The typist has to give it a complete form, and if necessary, he takes out two (or sometimes three) copies also It is of great importance that the typist must know the exact form and arrangement of different kinds of Government communications

The typed letter is then again sent to the Officer for his *signature*

10 Despatching—Afterwards, the file is given to the Despatch Clerk who puts a number and the date on the fair copy as well as on the draft (or the carbon copy, if any) A brief record of all letters issued *from an office is also made in the Despatch* Book

The Draft (or the typed copy) with its file is sent back to its branch of issue, while *the Fair Copy is* made ready for being posted

The addresses on the envelopes (on which the words *'On His Majesty's Service'* are printed) are written by the Despatcher. He also writes his name and designation together with the name of the Department or Office in the *left hand bottom corner* of the envelope This is called "*Franking*" the cover.

The General Despatch Book

No.	Date of Letter	Date of Despatch	Address.	Subject	Remarks
371	Oct. 30	Oct. 31	Revenue Dept.	Leave of Mr C Jones	2 Enclos.

11 Filing or Record-Keeping—Lastly, the letters are tied together, subjectwise and in order of date, in separate files made of card board pads They are then stored in the Record Room

Note —In big Government Offices for example the Secretariats, Indexes are also kept up, in which the subject matter of all letters, both received and sent out is indexed The Indexes are very helpful in obtaining the necessary papers any time in future

Test Questions

1 Name the various departments of the Government of India and the official of each department to whom letters must be addressed

2 Mention the designation of the head of the following Provincial Departments Police Justice, Education Public Works, Post and Telegraph Agriculture Industries and Co operative Societies

3 "What do you understand by Office Routine" , what does it consist of ?

4. Name the chief stages through which an official communication has to pass before a case is complete

5 Write short notes on —

Labelling Docketing Referencing, Noting, Diarising, Franking Receipts and Issues

6 Show the rulings of an Office Register, with a specimen entry

7 How are letters usually filed in a Government Office , how does the method differ from that of a business Office ?

CHAPTER III

Official Drafting

Drafting in official correspondence means writing letters memoranda, etc As already pointed out the draft of an official communication is based *on the Notes The form and style of an official* communication is unchangeably fixed They are very formal and unlike private letters contain only dry statement of certain facts and figures The language is however more dignified respectful, and courteous

The following are the chief forms of Official Communications —

1 Letters	7 Demi Official Letters,
2 Memoranda,	8 Resolutions,
3 Endorsements	9 Notifications,
4 Circulars	10 Communiques,
5 Reminders	11 Despatches
6 Telegrams	

Letters--In Govt Offices letters are used when (*a*) the subject matter is important (*b*) the officer to whom it is addressed is of equal or higher rank and (*c*) to a private person a letter is written only when he holds some high position

Form and Arrangement of an Official Letter

An official letter consists of the following parts —

1 Name of Department
2 Reference Number
3 Name of the writer, his title or designation,
4 Designation and place of the addressee,
5 Place and Date of issue,

6 Salutation or Form of Address

7 Body of the letter

8 Subscription,

9 Signature and Designation of the writer

Name of Department—Where necessary, the name of department or office of issue is usually printed (or typed) in the top centre of the sheet, as :—

(1) Government of India,
ARMY DEPARTMENT

(2) Government of the United Provinces,
Education Department

Reference Number—It is written either in the centre below the Name of Department, or at the left top corner It is meant for being quoted in the replies, so as to facilitate 'Referencing' There are different ways of indicating it

1 No VII—37=Branch or Section No VII, and letter No 37

2 No P E—3/19='P E' is the Branch of issue, '3' is the No of file, and '19' the No of letter

3 No 179/24=Means 179 is the General Number and '24' is the number of Branch or Section

Name and Designation of the writer—First write the word '*From*' at the margin. On the next line, a little to the right begin the name and title or degrees of the writer, his designation or office on the next line, and below it the name of the place where necessary Each line should commence some spaces away to right of the previous one When the Designation is long it may be written in two lines

A comma should be placed after the name the title, degrees, etc , and a fullstop after the last line

Esq should be used with the name

Sometimes when only the Designation of the writer is given '*The*' should be put before it —

(1) From

J P Brown, Esqr, I C S,
Secretary to the Govt of the
United Provinces,
Allahabad

(2) From

The Secretary to the Government
of India,
Public Works Department

Designation and Place of Addressee—'*To* is written at the margin

As a general rule, the name of the officer addressed to is not mentioned (except in the case of a private gentleman) and his Designation alone is given on the line below '*To* Place is written on the second line towards the right

(*Note*—It is wrong to place a comma after '*From*' or '*To*)

(1) To

The Post master General,
Lucknow

(2) To

The Inspector of Schools,
Meerut Division,
Meerut

Place and Date—Generally the word '*Dated*' is written first then the name of the place and then the date itself *It occupies the centre of the page* Sometimes date is placed along with the Reference Number

(*Example*)

(1) Dated Simla, 11th of April, 1930
(2) Calcutta, the 1st January, 1930.

Salutation—It is written at the margin

The usual forms are *'Sir* or *Madam* to an individual, and *Gentlemen* or *Madams* to person more than one

A Lord should be addressed *My Lord'* or *My Lord Sir*

Body—The first sentence of the text commences by referring to the number and date (sometimes also the nature of subject) of the letter last received, or sent

The words *I have the honour to* ' are used by the heads of departments and by local officers such as Commissioners Collectors, etc when writing on their own authority

The words '*I am directed to* ' or '*I am desired to* ' are used in Secretariats of Local or Imperial Govts, as there the Secretary, Under Secretary or Registrar (as the case may be) writes and signs on behalf of the head of his department

Letters to the High Court or the Chief Court are addressed to the Registrar and similarly letters from the e Courts are signed by him In nearly all other departments they are addressed to and signed by, the Secretary

Subscription—The closing words in an Official letter are —

I have the honour to be

Sir (or *Madam*)

Your most obedient Servant

These lines are centred at the right hand bottom of the letter

Signature—Just below the line of your most obedient servant comes the signature of the officer sending the letter And below it is written his designation or office

Degrees and titles are not written with the signature except in the case of a military officer whose

rank may be stated in addition to his designation thus —

I have the honour to be,
Sir,
Your most obedient Servant,
Henry James Capt.,
Inspector-General of Prisons

Note —Study very carefully the following examples of official letters —

(1)

No 15 I/A

From

T R Elgin, Esqr, I C S,
Superintending Engineer,
Allahabad

To

The Executive Engineer
Etawah

Dated Allahabad, the 10th March, 1936

Sir

In reply to your letter No 132, dated the 6th March, 1936, regarding the construction of a Bridge over the Jumna, I have the honour to say that the scheme as at present is wanting in details

2 The plans are herewith returned for *showing the ground-floor* and cross sections of the principal roads leading to the proposed bridge

3 The Revised scheme should be re submitted at an early date for further consideration

I have the honour to be,
Sir,
Your most obedient servant,
T R Elgin,
Supdg Engineer

(2)

No 27/X—3

From
E M Durand, Esq,
Secretary to the Punjab Government,
Simla

To
The Inspector General of Hospitals,
Lahore

Dated Simla, the 4th May, 1936

Sir,

With reference to the correspondence ending with your letter No 52, dated the 1st instant, I am directed to convey to you the necessary sanction for increasing the pay of the Professor of Anatomy at Lahore Medical College, from Rs. 525 to Rs 570 p m

The Accountant-General has been informed of this

I have the honour to be,
Sir,
Your most obedient servant,
E M. Durand,
Secretary

Memoranda—They are used when the subject matter is not important, or when the addressee is of lower rank. Memos are generally used for private persons. A Memo is written in the 3rd person, without the forms of Salutation and Subscription, and it is signed by a junior. The name and address of the addressee are placed below the body in the left half.

(Example)

MEMORANDUM

No 15 C—2

Income Tax Office
Agra,
24th February, 1936

With reference to his application dated the 16th December 1935 regarding his objection to the amount of Income Tax assessed, B Satish Mukerjee is hereby informed to appeal to the higher authority in the matter

By order
H Prasad
Head Clerk

To
B Satish Mukerjee
Rais Hathras
Distt Aligarh

Endorsements When a copy of a letter is sent to an officer for information or when a letter is passed on to another office, the words

(i) ' *Forwarded in original (to be returned) to for favour of opinion*

or (ii) "*Copy forwarded to for favour of necessary information (or report or action, etc*
, are written at the foot of the copy or the original letter This is called an Endorsement It is chiefly used when there is no need of writing a covering letter

(*Example*)

Endorsement on Example Letter No 2 going before will appear as follows —

Copy of a Letter No 27 X-3, dated Simla, the 4th May, 1936, from this office to the Inspector-General of hospitals, Lahore —

With reference to the correspondence ending with your letter No 52, dated the 1st instant, I am directed to convey to you the necessary sanction for increasing the pay of the Professor of Anatomy at the Lahore Medical College, from Rs 525 to Rs 570 p m

---

No 130

Government of the Punjab,
May 4, 1936

Copy forwarded to the Accountant-General for information.

By order,
E M Durand,
Secretary to Government.

Circulars—When some information is sent to or required from several officers, a circular is used It may be in the form of a letter, memo, or endorsement, as required

(Example of a Circular Letter)

Judicial Department

No 361

From

S Simpson Brown Esq
Secretary to the Government
United Provinces

To

1 The Registrar High Court,
Allahabad
2 The Secretary Board of Revenue,
Allahabad
3 The Secretary Chamber of Commerce,
Cawnpore

Dated Nainital, the 20th July, 1936

Sir,

I am directed to forward herewith a copy of *Bill No VIII of 1936 for favour of opinion

The replies are expected by the 31st of this month at the latest

I have the honour to be
Sir,
Your most obedient servant
S Simpson Brown,
Secretary

**Note —The Bill referred to in the above letter relates to Income tax.*

Reminders—They are used to draw attention of officers towards letters which remain unanswered for sometime They may be written in the form of a letter or memo as thought fit but full particulars of the letter to which attention is drawn should be given Post cards are sometimes used for this purpose

(*Examples*)

I

No. 26

From

J. Martin, I. C. S.,
Collector and Magistrate,
Azamgarh District

To

The Commissioner,
Gorakhpur

Dated Azamgarh, the 20th Aug., 1936

Sir,

I have the honour to invite your attention to this office No. 59, dated July 2nd, on the subject of grant of Government lands to the local D.A.V. High School for building purposes.

I have the honour to be
Sir,
Your most obedient servant,
J. Martin,
Collector and Magistrate

2

UNIVERSITY OF AGRA

No. 141

Registrar's Office,
Agra, 8th March, 1936.

Requests the favour of an early reply to this Office No. 393 of 1936, dated the 1st February, 1936, regarding the number of private candidates in the B. A. and B. Sc. Examination of 1937.

By order,
P. Lal,
Head Clerk

To

The Principal,
S. D. College,
Cawnpore.

Telegrams—In Government offices telegrams are used in cases of real urgency. To minimise cost telegrams do not contain the forms of Salutation and Subscription, and telegraphic addresses (where existing) are made use of. They are also confirmed *by letters enclosing a copy of the telegram.*

(*Example*)

	TO	*Name* / *Address* / *Telegraph Office*	Accounts Madras
Sanction	payment	of	Rupees
9,165	to	Cochin	Durbar
for	1935	1936	
FROM	Finrev		

NOT TO BE TELEGRAPHED	*Signature and Address of Sender*	I. Kannathan, Secretary, Board of Revenue

Note—Here '*Accounts*' stands for the telegraphic address of the Account General's Office, and '*Finrev*' means the Board of Revenue.

Demi Official (D. O.) letters—When an officer writes in private capacity to another officer *in connection with some official matter*, then a D. O. letter is used. They are written for the purpose of (*a*) making

an enquiry, (b) or explaining some point They do not contain any official No, nor they are referred to in any official letter In form they are exactly like private letters

(*Example*)

Saharanpur,
June 18, 1936

My dear Mr Mackenzie

Received your letter No 137 of yesterday's date but I do not quite understand how to effect the arrest of Pt Hans Raj unless some charge is proved against him

I am keeping however, a close watch after him

To
P Mackenzie Esqr, Commissioner, Meerut

Yours Truly,
J C White

Resolutions—They are passed by the Departments of a Government after discussion or enquiry of a subject In most cases they take the form of Govt orders or decisions of general public nature They are written in the 3rd person

The names of the Government and the Department of issue are written first

Then follows a brief explanation of the subject matter of resolution

Then comes the reference to letters or documents on which the resolution is based

The text of the resolution comes next, and is followed by the signature and designation of the secretary of the Department

(Example)

Government of the United Provinces
Home Department

Received letters No 1/57 and 9/28 on the subject of Govt Scholarships tenable in England by natives of India

No 112

Nainital, 14th June, 1936.

Resolution

The Governor in Council has been pleased to direct that six State Scholarships of the value of £250 each per annum tenable for three years in England by natives of India, would be placed at the disposal of the Universities of Allahabad, Agra and Lucknow

Ordered that a copy of this Resolution be forwarded to the Finance Department, and that the Resolution be published in the *Gazette*

B N. Cole,
Offg Secretary to the Govt
of the United Provinces.

Notifications.—They are also written in the third person, and are used for the announcement in the Govt Gazette of appointments, promotions, resignations, and rules and orders, for general information. A copy of each such Notification is also sent to the person or party concerned.

(*Examples*)

1

PUBLIC WORKS DEPARTMENT
Irrigation Branch

Leave

Dated Nainital, September 13, 1936

No 1535 I E A of 1936 Mr Jwala Prasad, I S E, Executive Engineer, VI Sarda Division, is granted leave on average pay for four months with effect from October 1, 1936

By Order,
(Sd) *A C Dutt*,
Secretary to Government,
United Provinces

2

MUNICIPAL DEPARTMENT
Appointment

Lucknow, September 18 1936

No 2770/XI—6 Babu Gajadhar Prasad, the senior most Upper Subordinate of the Public Health Department is appointed as temporary Assistant Engineer, on probation for one year, with effect from the forenoon of September 4, 1936

By Order,
(Sd) *T Sloan*,
Secretary to Government

Communiques—*Whenever a Government* central or local, desires to inform the public of necessary

facts regarding some important situation, it is done by means of notifications published in leading newspapers They are called communiques'.

(*Example*)

> A press communique says —
>
> The following candidates obtained qualifying marks in the competitive examination for entrance to the Indian Military Academy, Dehradun held in Delhi in March and April, 1935 but were not successful in obtaining a competitive vacancy —
>
> B W David, Ahmad Din Zuberi, and Kailash Narain Bhal

Despatches—It is the name given to the correspondence passing between the Secretary of State for India (in London) and the Govt of India or the C-in C. of India, or the Governors of Provinces They are written in the first person plural using 'WE,' and are signed by the Governor-General or a Governor, and by the members of the Executive Council

The Secretary of State is addressed as '*The Right Hon ble*' or '*The Most Hon ble*' The form of salutation is 'Our Lord', and subscription is as follows :—

We have the honour to be,
Our Lord,

Your Lordship's most obedient servants.

(*Examples*)

No 33 (external)
Dated Calcutta, the 1st April, 1936

To

THE RIGHT HON'BLE VISCOUNT PEEL, G C B,
His Majesty's Secretary of State for India

My Lord,

With *reference to* your Lordship's despatch No. 36, dated the 11th January 1936, regarding the abridged edition of Thorton's *Indian Year Book*, we have the honour to enclose a copy of the letter marginally

Mr. Hunter's *Letter* dated 22nd March, 1936	noted, and to express our opinion *that the smaller edition of the* Imperial Gazetteer will be far more complete than the abridged

edition of Thorton

2. We might agree to the arrangement reported in Mr Hunter's letter on the understanding that the 5 volumes do not involve any increased expenditure beyond what is provided in his budget

We have the honour to be
My Lord,
Your Lordship's Most Humble, Obedient Servants.

(Sd) B Chemsford,
,, C C Monro
,, G S Barnes,
, W. H H Vincent,
.. M. Hailey,
,, C H A Hill,
,, M Md Shafi,
,, G R. Lownder

No 18 (Home) Dated India Office, London,
the 13th July, 1936

To

HIS EXCELLENCY THE MOST
HON BLE THE GOVERNOR GENERAL
OF INDIA IN COUNCIL

My Lord,

With reference to your Despatch No 33 in the Foreign (external) Department, dated 1st April last, I accord my sanction for the publication of the bridged edition of the Imperial Gazetteer on the lines indicated in Mr Hunter's letter

I have the honour to be,
My Lord,
Your Lordship's most humble, obedient, servant
(Sd) *H Peel*

Test Questions

1 Name the Chief forms of Official communications and indicate briefly the nature of each

2 Give a short description of the several parts of an official letter and show their proper arrangement

3 What differences do you note in the form and use of the following .—

(a) Letter, (b) Demi Official, (c) Memo and (d) Endorsement.

4 The Director of Public Instruction, Education Department, U P, writes to the Inspector of Schools to the effect that since July, 1929 no student married after January 1929 should be allowed to study in Schools or to sit in the Examinations Draft the necessary letter

5 The above letter is passed on to the Heads of Schools and Inter Colleges by the Inspector of Schools, Meerut Division What form should it take? Show how it will be written

6 Draft a notification announcing the transfer of Pandit Jagan nath Pande, B A , L. T , from Government High School, Gonda, to Nainital, under *Order No 1234/T of October, 1934, in place of Th.* Mahiraj Singh, B A , deceased

7 What is a Notification and when is it used? How does it differ from a Communique?

8 Explain briefly (a) Resolutions (b) Despatches.

9 Write a letter from the Secretary, Public Service Commission U P., to Mr. Hari Mohan Mathur, B. A., informing him that he has stood fourth in order of merit at the last P C S Examination and that he should present himself for an interview before the commission at 12 noon on 15th June, 1939, in the Commission's Office at Nainital

10 The Collector of Your District, in pursuance of a letter received from the Commissioner regarding the appointment of the Executive Officer of the Municipal Board, Sikandrabad, wants to have in private some clear guidance in that connection.

How should the Collector write? Draft this communication.

CHAPTER IV

Some Specimens of Official Drafting

1—(Application for a post)

To

The Secretary,
Public Service Commission,
New Delhi

Sir,

Having seen in the columns of the 'Leader' of yesterday that some posts of Routine Clerks have recently fallen vacant in the Imperial Secretariat, I beg most respectfully to stand as a candidate for one of them My qualifications are as under —

I am a Graduate in Arts of the Muslim University, Aligarh, having acquired the B A degree in the year 1932

I duly qualified myself for Government Clerical Service (Lower Division) in the examination of the Commission held in December, 1934

Herewith I attach a few copies of my certificates and testimonials, a perusal of which will give complete information as to my personal character and other attainments

I am a youngman of 22 and enjoy robust health

Lastly should I be selected, I may assure you Sir I shall not be found wanting in the most conscientious discharge of my duties

Awaiting to hear favourably,

I beg to remain,
Sir,
Your most obedient servant,
Rafiquddin Qureshi, B. A.

Railway Road,
Aligarh.
Dated 16th March, 1936

2—(Copy of a Testimonial)

Aligarh University M. A. O. College, Aligarh

14th April 1932

I have known Mr Rafiquddin Qureshi, as a student of this College for four years He has just secured his B A degree in the second division. He made a very favourable impression upon his professors as a most regular and painstaking youngman of intelligence and sound moral character

I hope he will have an opportunity of putting into practice what he has learnt here I can recommend him for a responsible post

(Sd) M H. NASIRI, M A., P H D.,
Principal.

3—(Copy of a Certificate)

GOVERNMENT OF INDIA

Public Service Commission

Mr *Rafiquddin Qureshi* (Roll No 631) has satisfied the Public Service Commission that he is fit for clerical employment under the Government of India as a *Lower Division Clerk*.

(*Examination, 1934*)

(Sd) E. H. BRANDON,
Secretary,
Public Service Commission

DELHI:
Dated the 30th January, 1935

Departments of the Government of India and attached offices located at the Headquarters are requested to recruit the holder of this certificate through the Public Service Commission only.

1—(Official Memo—Intimating an appointment)

GOVERNMENT OF INDIA

Public Service Commission

New Delhi, 20th March, 1936

Memorandum

With reference to his application dated the 16th March, 1936 for a post of a Routine Clerk, Mr Rafiquddin Qureshi is informed that he has been appointed as an assistant clerk in the Central Printing Office on a temporary vacancy lasting for about four months Pay Rs 80 p m, with usual house allowance

He should report himself at the Printing Office, Simla, at 10 A M, on the 24th March, 1936

C L Pande,
for the Secretary,
Public Service Commission

To
Mr Rafiquddin Qureshi B A,
Railway Road
Aligarh

(OR)

No C P O 26 28

GOVERNMENT OF INDIA,

Central Printing Office,

Simla, the 20th March, 1936

Memorandum

Mr Rafiquddin Qureshi is informed that the Public Service Commission have nominated him for a vacancy in this office The appointment is that of a temporary clerk on Rs 100 p m, without any allowances

2 In the event of his accepting the offer the exact date on which he will be required to come for personal interview will be intimated later

3. A reply preferably by a telegram is requested

D N Gaur,
Offg Deputy Controller,
Printing

To
Mr Rafiquddin Qureshi,
Railway Road,
Aligarh.

5—(Reply Accepting the Offer)

Telegram

TO { *Name* / *Address* / *Telegraph Office*	Controller Printing Simla	
Yours	C. P	26 28
Accept	Offer	Await
Intimation		
FROM	Rafiquddin	
NOT TO BE TELEGRAPHED	*Signature and Address of Sender*	Rafiquddin Qureshi, Railway Road, Aligarh.

6—(Memorandum)

No 827/A

Director of Public Instruction,
United Provinces
Dated Allahabad, the 5th May, 1955

With reference to his application made over to the Deputy Director of Public Instruction, United

Provinces, on the 19th April, 1936 for the post of a Sub-Deputy Inspector of Schools, in the United Provinces, enquires whether he is willing to serve on Rs. *100* per mensem in a temporary vacancy likely to last for about nine months, if one is offered to him

An early reply is requested.

By Order,
C. L. Mitra,
Head Assistant.

To
B. Ganesh Pershad Sharma, B A., L. T.,
Govt High School,
Sultanpur

7—(D O Letter—Asking for a report)

Meerut, 18th June, 1936.

My dear Mr. Mackenzie,

Please see this Office letter No 52-E., dated the 16th inst regarding conduct of T Swarup, Superintendent of Jail, and let me have your report at the earliest.

Sincerely yours,
C N. Martin

To
P Mackenzie, Esq,
Collector,
Muzaffarnagar

8.—(Letter—Govt Grant to a Municipality)

No 25

From
C. Morgan, Esq, M. D, C P,
Surgeon-General,
United Provinces.

To

The Secretary to Government,
Local and Municipal Department,
Allahabad

Dated Lucknow, the 13th January, 1936.

Sir,

I have the honour to state that the provision made in Grant No 3 of the budget estimate of the Khurja Municipality for the year 1936 37 is quite sufficient

2 The proposal of the Municipality to appoint an assistant Compounder on Rs 25 per mensem, and the provision of Rs 220 for repairs to the Hospital, appear very necessary

I have the honour to be
Sir,
Your most obedient servant,
C Morgan,
Surgeon General

9.—(Circular Letter)

No *B/3361 68/V-15(16) of 1934 35*

From

Rai Bahadur A. C Mukerji, M. A.,
Secretary, Board of High School and Intermediate Education,
United Provinces

To

The Heads of Institutions recognised by the Board of High School and Intermediate Education, United Provinces, for the Commercial Diploma Examination.

Dated Allahabad, the 15th December, 1935.

Sir,

I have the honour to draw your attention to the Syllabus in Typewriting for the Commercial Diploma

Examinations of 1935 and 1936 and to inform you that it has been decided that the examinations in Type writing for the Commercial Diploma Examinations of 1935 and 1936 will consist of two papers of the same type as the corresponding papers for the High School Examination The maximum marks and the time allotted to the papers in Typewriting for the Commercial Diploma Examination are as follows : -

		Marks	Time allowed
	Theory Paper	30	2 hours
Type-copying	(a) Passage & Letter	50	
	(b) Tabular Statement	20	1 hour
	Total	*100*	*3 hours*

I have the honour to be,

Sir,

Your most obedient servant,

W. G. Gokhale,

For Secretary

Test Questions

1 A friend of yours has applied to the High School and Intermediate Board of Education of your province to allow him to appear in the coming Examination as a private candidate in Inter Commerce

Write the application and the reply giving the necessary permission

2 From the Collector of your district write to the Commissioner asking him to sanction the appointment for three months of an Assistant Superintendent of Police, because of communal disturbances in the district

3 Draft an official memo accepting Babu Mohan Lal's resignation, who is a clerk, Judge's Court, in your district No certificate can be issued to him as he has not served for a full year in the office

4 From the Municipality of your town write to the Collector and Magistrate submitting the administration report and requesting sanction to construct a vegetable market near the main bazar at a cost of Rs 15 000, which is a real need of the town

5 From—Director of Public Health, U P

To—Health Officer, Bulandshahr

Say that a non recurring grant of Rs 500 has been sanctioned towards the malarial survey scheme of the Khurja town and inform the Acct General, U P, by endorsement.

6 Draft an official letter from the Collector and Magistrate Meerut, to the Commissioner, Meerut Division, Meerut, submitting the Administration Report of the Gaziabad Municipality, and say that the delay in its submission is due to the many changes which had to be made in it in consequence of the orders contained in letter No 2314/G of 28th August, 1934

7 Draft a letter to the Post Master General, U P, saying that you sent a m/o of Rs 120/ to Messrs Sarkar & Sons, Dharamtalla St Calcutta, about a month ago, but you have not yet received the payee's receipt

8 Request him to make an enquiry into the matter as early as possible

9 Your College authorities desire to construct a Hall at an estimated cost of Rs 20 000 Draft a letter to the proper Govt. Official, applying for grant of half the cost

SECTION II
BUSINESS TRAINING

INTRODUCTION

Human Wants—It is a fact of common knowledge that human beings have got certain wants and desires to be satisfied. The natural law of self preservation, working alike with all living beings, compels man to obtain the means of life for himself and for those dependent on him. It is essential for man not only to feed and clothe himself for the sake of mere existence but also to procure certain comforts and luxuries of life for the attainment of a higher state of development. Amongst the least civilized peoples of the world wants are merely a means of self preservation, whilst amongst others they are the means for further development.

(Occupations-Chart)

- Occupations—
  - *Extractive*—
    - Agriculture
    - Cattle breeding and Dairying
    - *Fishing*
    - Forestry
    - Mining
  - Manufacturing—
    - Hand Industries
    - Machine Industries
  - Commercial—
    - Trade—
      - Home Trade
      - Foreign Trade
    - Aids to Trade—
      - Banking
      - Transport
      - *Insurance*
  - Direct Services—
    - Domestic Service
    - Industrial Labour
    - Professions
    - Civil and Military Services

Occupations

Broadly speaking, human wants are of two kinds, material and non material The satisfaction of man's material wants depends on goods or commodities, for the production or acquirement of which man has to exert and make efforts of various sorts In a civilized state of society these human efforts give rise to a multiplicity of activities, which in course of time become separated into distinct callings or occupations For the sake of convenience the whole of these productive activities may be grouped into four main classes of occupations—Extractive, Manufacturing (or Constructive) Commercial and Direct Services The first two occupations, namely, Extractive and Manufacturing are, sometimes termed **'Industry'**

1. Extractive Occupations are those in which man is mostly concerned with the collection of products already prepared for him by Nature for example Hunting Fishing Mining Agriculture, Cattle-rearing, and Dairy farming In the latter three occupations, however, the application of human skill and efforts is more necessary

India being mainly an agricultural country 71 per cent of her vast population of 40 crores is engaged in agriculture proper 2 per cent. in hunting, fishing, cattle-breeding and poultry farming, and only about $\frac{1}{3}$ per cent in mining

2. Manufacturing Occupations are those which are concerned with the working up of raw materials (produced mostly under the extractive occupations) into finished articles or making articles more useful for further manufacture Amongst such occupations may be mentioned Spinning and Weaving Iron and Steel manufactures Flour mills Sugar refining, Paper making, Glass works etc, etc They include handicrafts and small scale industries as well as manufacturing operations carried on in huge mills

and factories **Constructive** undertakings include the building of houses, laying of railways, construction of roads and bridges etc The one great feature of manufacturing industries *of our times is the use of* intricate machines run chiefly by some motive power, such as, *coal, electricity, gas*, or even water

In India only 10 per cent of the population is occupied in the manufacturing processes, while in some of the Western countries 50 to 60 per cent is so employed Cotton, jute, wool and silk mills in this country provide work for over one fourth of the *industrial section of the population and this shows* that the textile industry is sufficiently developed in India Iron and steel works, other metallic manufactures, sugar making, tanning and leather industries, chemicals, flour milling etc are other large-scale industries carried on in this country

3. Commercial Occupations consist of all those activities of man which are concerned with the exchange of goods amongst men and nations The term '*commerce* is used in a wide sense and includes not only Home and Foreign Trade but different auxiliaries to trade and industry as well e. g., *Banking, Transport* and *Insurance These three agencies* are very necessary for the proper conduct and expansion of trade of a country

India is a very big country having a vast area of over 17 5 lakh square miles She carries on an extensive trade both home and foreign, which accounts for the employment of 6 per cent of her people During the year 1935 36, the total value of India's foreign trade amounted to Rs 297 crores of which imports account for Rs 99 5 crores and exports for Rs 197 5 crores (including the out flow of gold worth 44 crores during the year) Food grains, oil seeds and raw materials form the chief items of *exports* from India, and the *imports* mainly consist of machinery and mill requirements, and manufactured

articles. Banking, transport, and insurance, since they are not highly developed here provide employment for only 2 per cent of the people of this country

4. Direct Services—This class of occupations comprises all those persons who work in the various Public Departments, Army, Navy, Police, etc, and also those engaged in intellectual pursuits, such as, Teachers, Lawyers, Doctors of medicine, etc, etc The Labourers who work in mills and factories together with those who perform domestic service form an important section of this group

In India those engaged in the Administration and Public Departments average less than 2 per cent of the whole population The percentage of those engaged in domestic service, factory labour, and *intellectual professions comes roughly to 7 per cent* of the total population.

Test Questions

1. Name the chief Occupations of man, explaining the causes of all his (economic) activities.

2. Write down at least ten different occupations and classify them according to the Occupation-Chart you have seen.

3. What do you understand by the term 'Industry'? Name and compare the two chief occupations it comprises

4. Point out the distinction between :—

   (a) Manufacturing and Constructive Industries.

   (b) Direct Services and Public Services

5 What is 'Commerce', what branches of occupations does it comprise? Trace the relation of Commerce with Manufacture and Agriculture.

6 'India is mainly an agricultural country' How do you justify this statement?

CHAPTER I

BUSINESS OFFICE ROUTINE

Copying of Letters

The clerical work carried on daily in a business office is known as its routine The main part of *this* work is concerned with the *sending and receiving* of letters as well as keeping their record As a general rule in a small business house correspondence is conducted and its record kept by the *same* clerk but in large offices these duties are discharged by different persons

Correspondence is the soul of commerce Hence all sorts of letters and documents used in business should be preserved with great care because they form the record of transactions All business papers should be arranged and kept in such a manner that whenever required they can be found easily and without loss of time

The usefulness of a complete record of business correspondence may be briefly stated —

1 It enables a merchant to *follow up* an Enquiry, if the order is not received within a reasonable time

2 If a *repeat order* is received from a customer, the necessary particulars can be found out from the last order

3 In case of a law suit letters can be produced in the courts as evidence

4 Much valuable information can be gathered from past letters for example the number of orders

received in one year can be compared with that of another

NOTE.—1 *Follow up* is a system of correspondence whereby a trader or merchant goes on sending letters to a customer who might have made some enquiry until an order or a reasonable reply is received.

2 *Repeat Order* It sometimes happens that a customer instead of giving full particulars of goods ordered simply refers to past order to be executed either in whole or in part This is known as a Repeat order and is so used only when the things required are quite familiar and of one or two kinds only

In fact, a merchant who keeps complete and systematic record of correspondence possesses at all times true and full information about the affairs of his business He will have little chance of being deceived by his assistants or following their wrong advice

For the sake of clearness in explanation, Business Correspondence may be divided into two sections—*Outward* and *Inward*

Outward Correspondence

All sorts of letters, telegrams, invoices, etc., sent out from a business office are collectively known as '*Outward Correspondence*'

Copying :—It has already been pointed out that past letters are very often required for future reference and sometimes for legal purposes, therefore, a *fac simile* (that is, an exact copy) of every outgoing business document must be kept in the office

Methods of Copying —Formerly, a copy of a letter had to be written out by hand, it was a laborious and time wasting process Mistakes were often made in the copies, and not being *fac similes*, they were not accepted as true in the law courts,

Moreover when in a modern business office many letters have to be copied daily this method of hand copying is altogether unthinkable Hence to meet these difficulties other methods of copying business documents have come into use They are—

1 The Press copying Method

2 The Carbon copying Method and

3 Copying Machines

Each of the above methods will now be described in some detail

The Press Copying Method

We require seven things to copy a letter in this way —

(1) The Iron Press

(2) Copying Ink or Pencil

(3) A Letters Copy Book

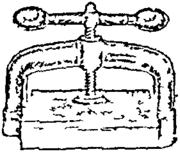
(4) A cup of Water

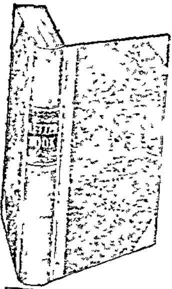
(5) A flat Brush

(6) Oiled sheets and

(7) Sheets of Blotting paper

LETTER COPYING PRESS





LETTER COPYING BOOK

Note.—The Letters-Copy Book is made up of very thin leaves called tissue sheets which are numbered serially on only one side of the page at the right top corner. In some books the leaves are quite thick but they have the quality of absorbing ink. In the beginning of this book some pages have ruled lines and on the outer edge of each page there is printed an alphabet—A,—B,—C,—D...... ...... X, Y, Z These pages are meant for writing the Index.

How to Copy a letter

(a) A hand-written letter.—First, the letter must have been written with the copying ink (or with a copying pencil) and allowed to dry. Now take up the Letters Copy Book and open the page on which you want to copy the letter. Suppose it is page *4* Place an *Oiled Sheet* on the back of page 3, and turn over it page 4. With the brush and water dampen the back of this page, taking care not to apply water on the numbered corner and at the binding of the book. On the wet page place a sheet of Blotting Paper and then an Oiled-sheet. Close the Book, press it *tightly* in the *Press*, and take it out. Open the Book and between

the wet page and the Blotting Paper now place your written letter facing the wet page. *Close the Book* carefully and press it again *firmly* for about half a minute. On opening the Book a *fac simile* copy (*negative of course*) will appear on the back of page 4 which can be read correctly from the other side.

The two oil sheets should be left in their places until the page is quite dry.

Note.—By placing an Oiled sheet and a Blotting Paper in front of each page several pages can be dampened one after another and then up to a dozen letters can be copied together.

(*b*) **A typed letter.**—*When we have to copy a* typed letter (which must be typed with a copying-ribbon) the method differs a little. Proceed thus:—

Open the page where the letter is desired to be copied. On the left page place an Oiled *sheet and on* it a sheet of India rubber or linen which is already kept moist in a Bath Tray. Turn over the right leaf *and on its back place the typed letter face down.* On the letter place a sheet of Blotting Paper and an Oiled sheet. Close the book and press it *tightly* for about a minute. *The copy will appear on the wet* page.

NOTE.—*A Loose Copy.*—Sometimes a loose or extra copy of a letter is also required. It can be obtained by placing a loose sheet of paper (of the same kind as in the book) in front of the page on which the first copy of the letter is to come. When the bound up page is being wetted enough water must be applied *so that the loose page may also* be dampened thoroughly. The rest of the process is the same as usual.

Caution.—In the Iron press Copy method one point to be carefully noted is that the moisture in the paper should be *of right amount.* Since if there is too much water the ink will spread mixing the words together, and on the other hand, if the paper remains too dry the copy will *be faint* or it might even not come at all.

Spoiled Sheets—If any leaf of the Letters Copy Book is spoiled somehow it should be cancelled but not torn out or removed, because otherwise the page-numbers will be affected and such a book will not be recognised in the Court. Torn out sheets should be repaired with gum.

The Carbon-Copying Method

This is the simplest method of copying letters, and the copy is produced just when the letter is being written or typed.

Duplicating Books—Orders, Invoices, Receipts, etc., are generally copied in what are called carbon Duplicating or Manifold Books. These books contain printed forms of the above named documents Each two leaves bear the same serial number and the upper one is perforated near the binding A sheet of carbon paper is inserted face down between each pair of leaves, under which is placed a piece of tin or cardboard. The writing is done on the upper page with a pencil The written sheet is torn off and the copy remains in the book.

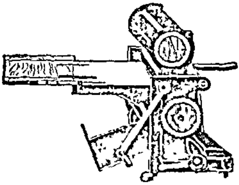
Type Copies—Now a-days, letters are mostly typed on a type machine and so the copies are produced as follows:—

A carbon paper is placed between two plain sheets and they are fed into the typewriter such that the carbon paper faces the sheet on which copy is to come While the letter is being typed it is also being copied. Thus, two or more copies of the same letter can be produced by using additional sheets and carbon papers

The best method of the above is to gum on the top at the back of each letter sheet a thin paper, known as a "flimsy" The great advantage of this is that the typist has simply to slip the carbon paper between the two sheets, and the whole can be most easily fed into the machine.

Copying Machines

We are living at present in the machine-age; much of our work can be done by machines far more easily and rapidly than ourselves. Machines invented for purposes of copying letters are generally called 'Rotary Copiers,' because it is by the rotation of certain parts in them that a letter is copied.



THE ROTARY COPIER (ROKEO)

The Rotary Copier—How to use it :—

A roll of specially manufactured paper is fitted into the machine, and its free end is attached to a cylinder Under the roll of paper there is a rubber roller *Letters to be copied are placed on feed* board in front of the machine When the handle is rotated, each letter is pushed in It is gripped between the roll of paper and the rubber roller, and is carried away to the other side, where it drops into a tray. The copies of letters come

one by one on the roll of paper, which goes on wrapping round the cylinder Afterwards the copies are cut off with a lever knife in the machine

Note—After the letters are copied a rubber stamp bearing the word COPIED is put on each letter, so that it may not be copied again

Comparison of the Three Methods

The Press copying method takes much time and the copies are not quite neat and clear But it has one great advantage *in that the signature on the original* (and also corrections, if any) appears on the copy as well Therefore, except in some Government Offices, it is not much used by business men these days

The Carbon method is very simple, neat, as well as cheap, but signatures have to be made on each single copy and this surely takes time Again, in law courts such copies are not always recognised. Still, because a good copy can be produced just along with *the letter, this method is being much used in* almost all offices Such copies are also easy to file

A Copying Machine though very quick, simple, neat and complete, is a costly thing Hence it can be used with advantage only in very big business offices, where a large number of letters have to be copied every day The greatest advantage of copies taken out on the Rotary Copier is that they are *fac simile* impressions, together with signatures, of the letters sent out, and being loose they can be filed along with the letters received

Test Questions

1 What is the need of keeping copies of Outward Correspondence? Do you copy your private letters? If not, why?

2 What do you understand by the Routine of a business office? What part does correspondence play therein?

3 How is the record of Outward letters kept? Name and explain the different ways of Copying letters

4 Describe briefly the Copying of (a) hand written letters (b) typed letters, on the Iron Press. Note the difference in each case

5 Is it possible to get two copies of the same letter by the Press Copying method, how?

6 Which of the Copying methods is the best in your opinion? Give reasons

7 Write short notes on :—The Letters Copy Book, Manifold or Duplicating Book, A Loose Press Copy, Copying Bath, 'Follow up' system, a 'Repeat Order', and a 'Flimsy'

CHAPTER II

Indexing the Letters Book

When a number of letters have been copied in the Letters Copy Book, the finding out of any particular copy, whenever required, must certainly be a matter of great worry as well as delay But a way has been found out of this difficulty by keeping an Index to every Letters Copy Book.

An Index is an alphabetical list of matter in a book, showing where each topic is to be found Such a list appears at the end of nearly every big book, and the student is expected to be already familiar with it. But the index used for business books differs largely from indexes found in ordinary books It has two forms (1) the Book Index and (2) the Card Index, which is explained in Chapter IV.

The Book Index—It consists of some ruled pages, with sheets of blotting paper between them all bound up in the beginning of the letters Copy Book. On the outer edge of each page is printed an alphabet, and the edges are so cut that the letters A, B, C, D X, Y, Z, all appear together one below the other.

Indexing means to keep an index, which may be done either on the *Simple System* or on the *Vowel System*

(a) Simple Indexing—In this system the names of customers are written in the index-pages according to the first letter of each name All names which begin with 'A', will be written on the page marked 'A'; those beginning with 'B', on page 'B', those with 'C', on page 'C, and so on The last page is usually

marked with XYZ and is meant for names commencing with each of these alphabets because such names are very few. Against the name of each person or firm are put down the numbers of the pages on which the letters sent have been copied. Note the specimen below —

Simple Indexing

	A
Adams, John	4 11
Ahmad Khan & Sons	1 7 13
Anmolak Ram & Bros	9
Abdul Kareem & Co	2 6 10
Asa Ram Janki Prasad	3 5 8 12
Alexandra & Co. P.	14 23
Asiatic Trading Co	17
(and so on)	

N. B.—*European names are indexed according to the surname* that is the last part of the name. In the above the correct names are '*John Adams*' and '*P. F. Alexandra & Co.*' When indexing the names words such as Mr., Messrs., Babu, Seth, Esq. should be left out and words like Dr., Sir, Lord, Miss, Mrs. etc. should be placed *after the name.*

This system of indexing is useful in small offices only. In large firms, companies, banks etc. where thousands of names have to be indexed the vowel system is far better.

(b) Vowel Indexing—Here each page of the index is divided into six sections in accordance with the six vowels—*a, e, i, o, u, y* and *a name is placed in that section which corresponds with the first vowel coming after the initial letter of the name.* The names to be written on any page must all begin with the

same alphabet as marked on its edge. The following illustration will make it clear.—

Vowel Indexing

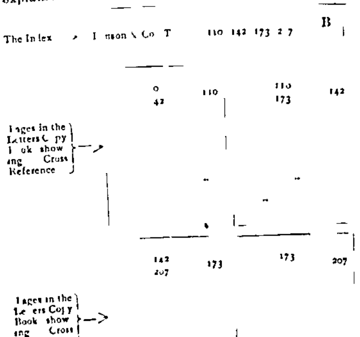
				A
a	Anand Swarup & Sons		3, 7	
	Amla Saran & Co	—	9	
	Ahmad Husain Ibrahim Khan	—	16	
e	Allen & Co., G	—	2, 11	
	Alexandra Cinema Co.	—	14	
i	Aziz Uddin & Bros.	—	1	
	Amir Husain & Sons	—	4, 8	
	Asiatic Trading Co	—	12	
o	Amolak Ram Ratan Lal	—	5	
	Arora Bros & Co.	—	15, 19 21	
u	Abdul Salim, Abdul Karim & Sons	—	10, 17	
y	Addy Benjamin, M	—	6, 13	

Note—In actual practice both the sides of a page are utilized, making 3 sections on the front and 3 on the back. Sometimes when names are many six pages of the Index may be used for each alphabet, *e. g.*, one page for 'A*a*', one for 'A*e*', one for 'A*i*', one for 'A*o*', one for 'A*u*', and one for 'A*y*'.

Cross Reference—It is a device to facilitate the searching out of a letter in the Letters-Copy Book. The various copies of letters sent to the same person are marked with a fraction. The numerator indicates the page number of the pervious letter, and the denominator indicates the page-number of the letter following. The Cross Reference is also known as '*Page Index* or *Chain Index*' and is usually done with

a coloured pencil at the time when a letter is being indexed

The chief use of a Cross Reference is that while searching for a letter it points out at once the page of the letter (of the same person or firm) going just before and the one coming just after We have not to look at the Index again and again It thus saves time still further The following diagram clearly explains it —



NOTE.—The zero in $\frac{0}{142}$ shows that there is no letter previous to it; and the blank in $\underline{173}$ means that there is no letter further. When any more letter to T. Benson & Co., is copied (say on page 235) it will be completed as $\frac{173}{235}$, and then Cross Reference on page 235 will appear as $\underline{207}$ until further letters.

Test Questions.

1. What is an index? Name its kinds, and explain the Book-index.

2. Explain and illustrate 'Vowel System' of indexing. How does it differ from 'Simple Index'?

3. From the following prepare (i) a Simple Index; (ii) a Vowel Index.—

The Modern Book Depot	... 9, 13, 27
Munna Lal & Sons	... 3, 7
Mohan Bros. & Co.	... 1, 10, 19, 25
Haji Muhammad Buksh, Kareem Buksh	... 2, 8, 11
T. Morris & Co	... 4, 18
The Modern Trading Co	... 6, 14, 17, 26
Pt. Murari Lal Sharma	... 5
Messrs. J. Mead & Co.	... 12, 16
Messrs. Macmillan & Co.	... 15
R. Minto & Sons	... 20, 24, 31

4. What is a 'Cross Reference'; Is it the same as a 'Letter Reference'? What useful purpose does it serve?

5. Suppose letters to a certain firm have been copied on the following pages of the Letters Copy Book, show the Cross Reference on each page:—

42, 57, 73, 81, 99, 115

6. Is the Index still necessary, when you mark the Cross Reference on the copies in the Letters Copy Book? Discuss.

CHAPTER III

Making up, Recording and Despatching Letters

Folding—Business as well as Official Letters should always be folded very neatly because carelessness in this respect creates a bad impression about the sender Care and neatness always win confidence, self respect and goodwill, which are so very essential in business A letter should be so folded as to fit the size of the envelope used.

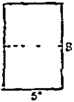
The papers and envelopes most commonly used are of the following size —

	Papers			*Envelopes*	
1	Note Paper	8"×5	1	Squar	5½"×4½"
2	Letter Paper	7"×9	2	Oblong	4¾×2¾"
3	Business Letter paper	10½"×8½"	3	Commercial	6"×3½"
4	Foolscap paper	13½"×8½"	4	Official	9"×4

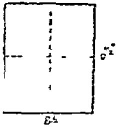
How to fold—The following diagrams illustrate the proper way of folding a letter paper for each kind of envelope Students should see and do it for themselves—

(1) For a Square Envelope, fold—

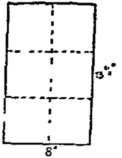
A Note Paper, thus



A Business Paper, thus

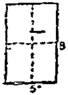


A Foolscap Paper, thus

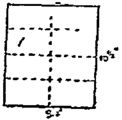


(2) For an Oblong Envelope, fold—

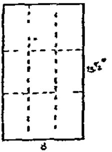
A Note Paper, thus



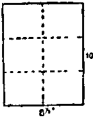
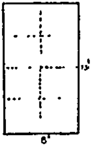
A Business Paper, thus



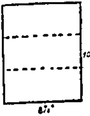
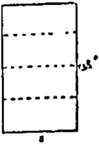
A Foolscap Paper, thus



(3) For a Commercial Envelope, fold—

A Note Paper, thus	A Business Paper, thus :	Foolscap Paper, thus :
		

(4) For a Foolscap Envelope, fold—

A Note Paper thus	A Business Paper, thus	A Foolscap Paper, thus :
		

Addressing Envelopes—The addresses on envelopes and wrappers should be written quite correctly and neatly. If an address is not complete or is incorrectly written, the letter will not reach the addressee in

time, or even it may not be delivered at all The writing should be bold and legible, the whole address being spread on the lower half of the envelope according to its size

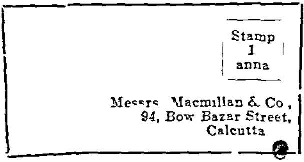
How to write the Address—The name of the person, firm or company is written in the first line The designation or occupation, the street number name of the road or bazar is written on the second line, a little to the right of the first line The name of the place itself is written on the next line towards the right

If the place is a small town or a village it should be underlined The name of the district, province, *state, or country (if necessary) should be placed in* brackets at the right end.

Should a letter appear to be rather heavy do not forget to weigh it on the *Letter Balance*, and then affix stamps accordingly at the right hand top corner of the address side

[NOTE.—It is very important that the Despatch Clerk is well acquainted with the latest rules of the Post Office. He should better keep a copy of the Postal Guide to be referred to in case of any doubt as to the amount of postage and other regulations]

Specimen Address



The Address Book—The addresses of various customers may be copied from the letters received. As a general rule, however, an Address Book is kept in which the names and addresses of all regular customers are written up in alphabetical order. When the addresses are kept on index-cards, (as explained further) this book is not necessary.

A Specimen page of an Address Book

Name	Address	M
Macmillan & Co	Book Sellers, 294 Bow Bazar Street, Calcutta	
Modern Trading Co	Nawabganj, Rampur (U P)	
Munna Lal & Sons	Soap Merchants, Kamboh Gate Meerut City	
Muhammad Bakhsh Karim Bakhsh	General Merchants, Sadar Bazar, Delhi.	
Central Bank Ltd	27, Chandni Chowk, Delhi	

The Letter Sorting Rack—Great attention should be paid to putting letters in their respective envelopes together with correct enclosures, if any. To avoid mistakes a *Letter Sorting Rack* is sometimes used for this purpose. It is a wooden almirah with several divisions, each marked for a certain class of letters or documents. As soon as letters are copied, they are placed along with their enclosures in these divisions to be ready for the despatch clerk.

The Postage Book—When the Despatch clerk has got ready all the letters, parcels, etc., for the post,

he records them in the Postage Book, the form of which is shown below —

The Postage Book

Stamps or cash	Date	Name and Address	Kind of article	Time	Postage
Rs. a. p	1935				Rs a p.
Cash 4 5 3	Dec 1	Amolak Ram Ratan Lal, Poona.	Letter	8-30 A M	0 1 6
Stamps 5 10 9	„	Friend & Co, Lahore	Card	4 P M	0 0 9
10 0 0	„	G Allen & Co, London	Parcel	10 A M	1 3 0
	2	National Trading Co Madras.	Regd. Letter	4 P M	0 4 0
	„	Imperial Bank, Delhi	Telegram	9 A M	0 9 0

The objects of keeping a Postage Book are —

(1) Letters and parcels, in doubt, can be traced out,

(2) A correct record of all postal expenses can be properly kept,

(3) The clerk cannot mis use the stamps or postage money given to him,

(4) Certain postal expenses to be recovered from customers can be easily known

The Parcel Post Register.—*Ordinarily, a receipt is obtained from the Post Office for any parcel that may be sent through it* When such parcels are few the receipt is given on the Post Office forms, but when the number of parcels to be posted in a day is large, it is usual to enter them in a Parcel Post

Book The receiving clerk at the Post Office puts the date stamp in a column of this book, together with the number of parcels received and his signature

Parcel Post Register

Date	Name and address	Weight	Postage	Signature
1935		Tolas	Rs a. p	
Jan 3	Amar Nath Shree Nath Kari [illegible]	15	0 4 0	P O Stamp
	Rai [illegible] Bhagwan Das Cloth Merchants M[illegible]	8[illegible]	0 8 0	
	[illegible] Jewel [illegible] 14 Ch[illegible] Calcutta	25	0 4 0	3 H Ahmad

The Peon Book —Whenever a letter or a parcel is delivered in the same city through a messenger or servant the record of such articles is kept in a separate Peon Book The addressee to signify that he has duly received the articles sent puts down his initials in this book The word 'Hand' is written at the top left-hand corner of an envelope so delivered and if answer is desired, 'Await Answer' is also added

Peon Book

Date	Addressee	Kind of Article	Initials of Receiver
1935 11 10	Messrs. Sharma Bros & Co	Parcel	[illegible] Sharma
	Mr L N Mathur J A S High School	Letter	[illegible] Mathur
15 10	The Agent Imperial Bank	Letter	[illegible]

Petty Cash Book (On The Imprest System).

Amount in hand Rs a p	Date	Particulars	Total Rs a p	Stationery Rs a p	Postage and Stamps Rs a p	Cartage and carriage Rs a p	Sundries Rs a p
	1935						
10	January 1	To cash					
	" 1	By Stamps	1 4		1 4		
	" 2	" Pens and Ink	8 6	8 6			
	" 5	" Charity	1				1
	" 8	" Stamps and cards	5		5		
	" 10	" Tonga hire	1[illegible]			1	
	" 10	" Matches	2 6				2 6
	" 13	" Newspaper	1				1
	" 14	" Pencils and Ink	12 6	12 6			
	" 15	" Coolie	3			3	
	" 15	" Postage	1 10		1 10		
	" 16						
5 9 6		To cash	5 9 6	1 5	3 3	13	4 6
		By Balance c/f	10				
15 9 6			15 9 6				
10	" 16	To Balance					

CHAPTER IV

Filing and Indexing

Inward Correspondence – Inward correspondence means the letters telegrams and other papers received into a business office.

The Inward Letters Register —As soon as all the in-coming letters have been opened and read by some responsible person in the office, the receiving clerk marks each of them with a serial number and the date of receipt A rubber Dating stamp is generally used for this purpose A brief record of each letter is then made in a Letters Register, which is also called '*Inward Letters Book*', or *Letters Received Book.*' The following is an example :—

The Inward Letters Register

Date	No.	Name	Place	Subject	Remarks
1935 May, 1	1	Macmillan and Co	Calcutta	Price List	Filed
" 1	2	Gaya Prasad and Sons,	Agra	Order	Goods supplied
" 2	3	Ram Dayal Sharma,	Aligarh	Offer for Agency	Refused
" 3	4	Allahabad Bank Ltd,	Meerut	Terms re a/c	
" 4	5	The New Paper Mills Ltd.,	Lucknow	Samples	Approved
" 4	6	The Modern Book Depot.	Agra	Invoice	Checked and filed

There are three fold objects of keeping this book :—

1 It forms a complete record of all the letters received daily into an office

2 Sufficient information about a letter is got from this book, and therefore it may not often be necessary to read the letter itself for reference

3 The 'Remarks column at once draws attention to a letter which remains unreplied, for it will be blank in that case, such as letter No 4 in the above example

Preservation of Inward Correspondence—Modern business requires the handling of a vast number of letters both inward and outward and it is of utmost importance to a business man to be able to find out a particular letter received or the copy of a letter issued with least possible delay and worry

In business 'time is money , and any time lost in searching for letters means so much unnecessary loss of money or at least delay in effecting business. Secondly if past letters could not be secured as and when required it would be a source of much mental worry to those who manage the business and so they cannot carry on their work as efficiently as they should otherwise do It is why every up-to-date modern business always makes use of several devices for preserving correspondence in such a way that reference to them can be had as easily and speedily as possible

We have already explained in this connection how copies of outgoing letters are taken out and properly kept for future reference Now, we shall describe how inward letters are preserved and for

what reasons It is of utmost importance to preserve all inward letters for the following reasons :—

(a) They contain the terms and conditions agreed for the supply of goods

(b) A repeat order from a customer necessitates the reading of past letters,

(c) Law requires the preservation of some documents for a certain number of years,

(d) They serve as useful evidence in legal cases,

(e) The result of trading for one year can very usefully be compared with that of another.

Filing is the name given to that method or system by which letters received (and if possible, also copies of the outward letters) can be preserved for future reference in such a way that any one letter, from the whole large group, can be readily obtained.

Essentials of a good Filing System—A system of filing to afford the maximum advantage should possess the following essentials :—

1. *Simplicity* The device or apparatus used should be simple enough so that it could be properly handled by any person of average ability.

2 *Rapidity of Reference* The arranging of papers in their proper places and reference to them should be done with the least possible delay. It should be self indexed as far as possible.

3. *Safety of Papers*. The papers should be preserved intact, that is, without being spoiled by dust, insects, rats, etc

Further, they should be protected against being taken out or substituted by un authorized persons This requires some fastening or locking arrangement.

4 *Elasticity* The system adopted by a business must not only be suited to its special requirements but it must also be capable of being expanded with the increase in the size of that business and of being contracted if need be

5 *Economy* The filing apparatus should not occupy too large a space and also its cost should be reasonable for the size of business desiring to adopt it.

There is however no one system of filing so far devised that may be regarded as suitable for meeting the needs of all kinds of business houses large as well as small We know that businesses differ as regards their nature and the amount of correspondence required to be handled and so a system of filing which may be just serviceable for one office need not be equally so for another office Hence it is not possible to recommend any particular system as the best and suitable for all the needs of every business office Any system selected must be such that it could be easily adjusted to meet the special requirements of an office and not that the office may have to adjust itself according to the nature of the system

Methods —There are three principal methods of preserving inward letters —

1 Simple filing

2 Pigeon Hole Docketing

3 Drawer filing which may be done on (a) the Flat system, or (b) the Upright system

Simple Filing

A Wire File—*The readers of this book must be* familiar with the way in which post cards, postal

receipts, vouchers and receipts for small payments, and any other piece of written paper which we think will be needed later on are preserved by us All we do is to pierce these papers on to a hooked piece of wire and then hang the whole on a nail We go on doing this till either the wire is full or the papers are no longer required to be kept with us We may call it a *Wire file*

The greatest drawback of this arrangement is that whenever any paper at the middle or bottom of the wire has to be removed the order of all the rest of the papers above the particular one taken out is disturbed, and it becomes extremely bothersome to replace all the papers in their correct places afterwards

So this method of preserving papers is rather crude and it certainly cannot be used for keeping letters, important papers and valuable documents of big business houses It is, however, mostly employed by small retail traders, and for our private requirements

Cardboard Files

Even the *card board files* which are generally used in Government and semi government offices, are not very serviceable for the requirements of business houses Such a file consists of two pieces of carboard of the size of a F scap sheet, the lower one having a flap and a tape to tie round the middle

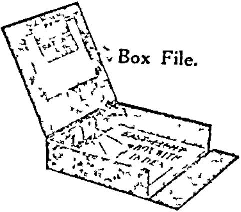
In modern business therefore other better sorts of files are made use of *e g* a Box File An Apron File or a Double Arch file They all belong to the simplest system of filing business correspondence

The common feature of these files is that *letters* are *placed in them date wise* The file itself may be put on the table on the shelf of an almirah, or it may even be hung on to the wall if the make of the file permits of this being done When letters become sufficiently numerous they are removed from the

files, numbered consecutively bound together, and then stored away in some safe place. A brief index is also sometimes attached to each packet.

Some of these simple files are described below —

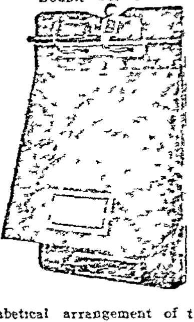
The Box-File—It is merely a box, a little larger in size than a F'scap paper. It is made of card-



board or very thin wood. Inside it there is usually a spring which keeps the letters together in position. The box may have a lid or may be open on the upper side.

The Apron File—It consists of a stiff cardboard at the top of which there is a clip to hold fast the letters. In front there is a stout paper to cover the letters in the fashion of an apron. But still the letters in this file get dusty and their edges are often torn.

The Double Arch File It consists of a back board with two metal arches at the top and a hole for hanging the file on to the wall At the lower end of the board there is a small file-punch by which two holes are made at the upper end of letters before they are inserted through the arches

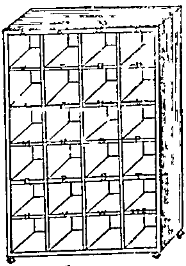


This file has proved very popular, since, while the letters are held securely in their places, any one of them can be lifted and read through when required. The index sheets help the alphabetical arrangement of the letters

Pigeon Hole Docketing

Although it is an old system of preserving letters, it is still largely in use It requires a big wooden almirah having 24 compartments There is a revolving shutter in the front, which can be pushed up and down as needed The compartments resemble the holes in a pigeon nest hence the name Each hole is labelled with an alphabet A, B, C X, Y Z

Docketing—Before being placed in the almirah the letters are first folded into a uniform size according to the width of the compartments On the outside of the folded letter the following points are briefly noted down —



SKETCH OF A PIGEON HOLE CABINET

1 The name and address of the sender

2 The date of the letter

3 Its subject matter

4 Remarks and date of reply

This is called a *Docket* and is extremely helpful in searching for a particular letter If the outside of a letter is filled up in writing the docket is written in red ink The following are specimens of dockets —

Docket of a letter	Docket of an invoice
Gaya Prasad & Sons	The Bengal Paper Mills
Agra	Co Ltd
Dated 5th May 1935	Calcutta
Order for 10 Reams	11th June 1935
of F cap Paper	Amount Rs 500-4-9
Supplied—	Cheque sent for Rs. 500
8th May 1935	1st November 1935

Docket of a statement [illegible]

The New Fren s & Co
A arb
Ja — 1 e 0,,
Rs. 5 4 6

The docketed letters are placed date wise in different holes of the almirah according to the alphabets with which the names of the senders begin. After every three or six months (or any convenient period) the letters are taken out of the pigeon holes They are sorted both alphabetically and date wise and then tied up between pieces of cardboards. A label i affixed to each bundle thus—

LETTERS	ORDERS A
A to H	INVOIC S
Jan.—June	Jan —June
1935	19,,

The bundles are then stored away usually on the top of the Almirah

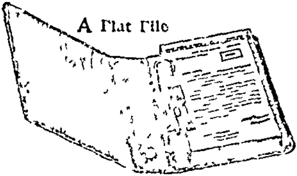
[N —In a u practice two or three Almirahs are used for exam e one f l e ne for nv ces and statement.]

Drawer Filing

This is newer and better system of filing letters It is becoming increasingly popular, because *not only the inward letters but also the cop es of o ward letters can bo h be placed together* It require a filing cabinet consisting of a single drawer or more The le ters are placed in the drawers in t vo ways—Flat system and Upright system

1 **The Flat Filing System**—In the Flat or Horizon tal system of filing the Drawer Files are generally

used, of which there are many makes and each differs more or less from the other, for example,



the Pilot the Shannon, etc For some files holes have to be punched in the letters before they can be placed *inside the drawer*, *in others there is an* arrangement of spring fastening which keeps the papers quite secure in their place But the things common *to all such files are that there is an alpha* betical index inside the drawers and that the letters lie flat in them

Special Features—*There are four special features* of a Flat File —

1 *The Shape and Position of the File* The shape and *design of these files* varies considerably some files can be *hung on the wall*, *others are placed* like a book on the *shelf of an almirah*, and still others are usually in the shape of a drawer.

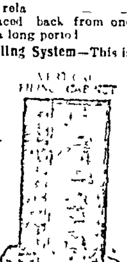
4 *The Transfer Files or Binding Cases*—When a flat file is full, or at definite intervals of a quarter, half year or a year, its contents are removed to another file called a Transfer File This file also contains an alphabetical index, and the dates covered by the letters transferred to it are marked on its back side e g, *'from 1st July to 31st Dec, 1936'*

Most usually, however, the letters are removed to Transfer or Binding Cases (of the same size as the files themselves) without disturbing the order in *which they were lying in the drawers* Labels as shown here are put on those cases which are also cross referenced In this way the letters relating to a customer can be traced back from one Transfer Case to another, over a long period

Letters
A to H
June to
September,
1936

2 **The Upright or Vertical Filing System**—This is the most modern and efficient system of filing so far devised It is this system in which the inward letters as well as copies of their replies can both be filed together

VERTICAL FILING CABINET



Papers are arranged in folders which are placed in an upright or *standing* position in the drawer hence it is known as the Vertical System of Filing

A Vertical Filing apparatus consists of the following things

1 **A Cabinet**—For upright filing large and deep drawers (Generally 24"×10"×10") are used as the papers,

instead of lying flat remain in a vertical position in them They are fitted into a cabinet, and can be pushed in and out quite easily The number of drawers depends on the size of correspondence to be filed All vertical filing cabinets are fitted with roller shutters and locking devices to secure privacy and safety for the papers placed in them

2 **Folders**—For each customer a *folder*, made of stout manilla paper, is used. The back edge of this folder is a little higher than the front, and on it are written the name of the customer and the number allotted to him The letters received from the customer (and also the copies of the replies sent to him) are placed date-wise in his folder Thus a folder contains the whole correspondence of each person or firm

The folders being loose without any fastening the whole of the correspondence of a person can be taken out most easily by lifting his folder out of the drawer This provides the greatest facility of reference

3 **Guide Cards**—Each Drawer contains a set of Guide Cards (made of strong manilla paper) having projecting tabs, on which is marked an alphabet, a number, or the name of a place or some subject The function of these Cards is to separate the Folders into their own groups They are held in position by a rod passing through the hole at the lower end of each Guide Card

4 **Transfer Cases**—They are boxes made of cardboard or wood and are of the same size as the folders They are meant for transferring to them the contents of a file when it is filled up with letters They are labelled as usual

5 **"Out Cards**—These Cards are coloured, and similar in size to the Guide Cards When a particu-

lar folder is taken out of the drawer an "Out" Card is put in its place, after having entered a few particulars in the columns ruled on the card for the purpose. The particulars about the folder generally are: (a) Name and address of the customer together with his number if any, (b) the date when it is taken out, (c) the name of the person or department to whom it has been sent.

When the folder is replaced the "Out" Card is removed. The chief advantage of the use of such cards is that as soon as a drawer is opened the colour of the card at once draws attention to the particular folder which is out, and that it should be placed back in its proper position as soon as done with.

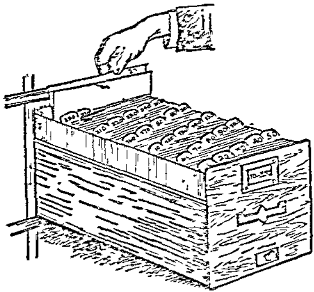
Arrangement of Folders in the Drawer

The Folders are placed in the upright position in the drawer between the Guide Cards, which are usually arranged alphabetically. They may, however, be arranged numerically, each Guide Card being marked in rotation with round numbers, such as, 10, 20, 30 ... 100, and so on. Geographical or subject-wise plan of arrangement of the Guide Cards is also sometimes followed.

(a) Alphabetical Arrangement.—When folders are arranged on this plan, only the names of customers are written on them and they are so placed that all the folders of 'A' names are behind (or before) Guide Card 'A'; folders of 'B' names are behind Guide Card 'B'; those of 'C' names are behind Guide Card 'C'; and so on. Each Guide Card thus separates its own folders from the rest and when any particular letter

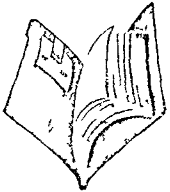
has to be looked into, these cards at once point out where to find that folder

(*b*) **Numerical Arrangement.**—In those offices where correspondence is heavy it is better to adopt the numerical plan of Upright Filing Here on the folders, in addition to the names of customers, numbers are also written, and the Guide Cards too show those numbers, and not the alphabets. These numbers, as a general rule, are not consecutive, but round figures, *e. g.*, 10, 20, 30. 40, etc. The folders are arranged in the drawer, in accordance with those numbers, behind their proper Guide Cards.



UPRIGHT FILE DRAWER
(NUMERICAL ARRANGEMENT)

FOLDER.



Help of the Card Index —When *folders are* arranged on the above *plan it becomes neces*sary to keep an index *of the* numbers in a Card Index drawer (explained further on) Thus when desiring to search for the folder of any particular person we shall first find out from this Card Index the number given to him, and then by noticing the Guide Card of that very number in the Upright File drawer we shall get the folder

(*c*) **Geographical Arrangement** —In this plan the Guide Cards bear names of districts provinces or countries and the folders bearing the names of customers with their places are arranged behind that Guide Card to which they belong

This arrangement is made only where the number of customers is very large and where there is regular correspondence to and from the customers of each district or province, *e g* in the offices of Banks and Insurance Companies

(*d*) **Subject wise Arrangement** —Sometimes it is necessary *to file the papers in accordance* with the subject or topic of the letters for instance correspondence *re import of Grammophones* Radio sets etc, or contracts embodying terms for the manufacture or supply *of some special goods* *The Guide* Cards are then marked with the appropriate subject headings, and arranged alphabetically *The folders*

also bear she same subject-headings and are placed behind their own Guide Cards Thus the letters on the same subject or topic are placed date wise in the same folder irrespective of the names of the writers

NOTE—**Alpha Numero Plan** —As the name indicates this is the combined plan of both the alphabetical and the numerical arrangements. *Its chief merit is this that it does not require a separate Card Index* and still possesses the exactness of the numercial plan

Here the Guide Cards are marked with the alphabets in the dictionary order and also with numbers (usually in the form of a fraction) which at once point to the group and exact position of a customer s folder Thus this plan provides a quick and correct reference no matter however large the correspondence may be The following example will enable us to understand this plan better —

Suppose we have adopted this plan and want to reach the folder of Messrs Mohan Bros We shall open the drawer and look for the Guide Card marked "MOH"—on which several names commencing with these letters will be found already written each along with its own numerical reference, which in the case of Mohan Bros may be assumed as 15/7 Of this No 15 points to the section in which the particular folder is placed, and No 7 indicates the exact position of this folder in that section, namely seventh

Superiority of the Upright Filing —*If we compare* the Flat Filing System with the Upright Filing, the latter is decidedly better, for the following reasons .—

1. There is no need of punching holes in the papers and no fastening is required, so much time is saved in filing the papers

2 Each customer's correspondence is quite separate *from the others*

3 Both Inward and Outward letters can be kept in one place

4 Reference is easy and quick.

5 Order of arrangement can be changed when needed

Nevertheless, the following advantages are rightly claimed for the Flat Filing System :—

1. Its cost is not much and so it can be used by small offices

2. It requires a little space, and is usually arranged on the shelf of an almirah, or on a table or desk.

3. Papers remain secure in their places, and so it is very useful for valuable documents

—— o ——

The Card Index

This is a very efficient system of indexing, and it marks a great improvement even over the vowel-system of Book-indexing already explained It consists of a Drawer or box, some Guide Cards, and a number of Name Cards

The Guide Cards—These are cards made of quite thick and stiff paper and each has a projecting tab on the upper edge, on which is printed an alphabet

The Name Cards—They are blank cards, about 5"×3" in size, and on each is written or typed the name of a customer, his address, folio or other number, subject heading etc One blank card is used for one name and it is placed in the drawer behind its own Guide Card, according to the first letter of the name

The Guide Cards are arranged in the drawer in the alphabetical order with the Name Cards being distributed amongst them in the same order.

They may be kept on the *simple system* as is most usually the case, or even on the *vowel system* according to the needs of an office The latter system wil , of course, require six Guide Cards for each alphabet (Aa, Ae, Ai, Ao, Au, Ay ; Ba, Be, Bi, Bo, Bu, By , and so on) ; and also the number of Drawers will then be at least five or even more

Indexing is done on the Name Cards just in the same manner as on the pages of a Book-index

another letter may be sent to the customer if nothing more is heard from him]

6 When the goods are sold on the '*hire purchase*', '*instalment-payment*', or '*trial-order*' systems the necessary particulars and conditions of sale offered to customers can be most conveniently recorded on these cards

7 A card-index *may be used for* maintaining a record of persons employed in an office, showing the name, address, scale of salary or wages, terms of appointment, etc of each

8 It *may be used as an index to* Library, Books, Price Lists, Trade Catalogues, etc

Advantages of the Card-Index—The Card-index, being the best system of indexing, possesses the following important advantages:—

1. It is most convenient to handle, and provides very quick reference With the help of '*Division Cards*' of different colours further divisions of a drawer are possible

2 *Its capacity for* expansion is great, as the number of drawers can be increased when required

3 The cards can be used *for various other* purposes, as already pointed out, both sides of a card being utilised if necessary

4 New cards can be added in their proper places without disturbing in the least *the alphabetical* arrangement *of the cards* already there This is not possible with a Book index which requires rewriting whenever there is any change

5. 'Live' cards alone, that is those belonging to the customers on the list, have to be handled, the 'dead' cards being removed to an 'out-of-date' drawer.

CHAPTER V

Postal Information

(Adapted from the Post and Telegraph Guide)

The Post and Telegraph Department has proved of such immense service to the civilized world that the Government of nearly every country conducts it under its own care and management. This Department carries on the work of transmission of news, small-weight parcels, money, etc., both for the general public and the Government. To business men it is of special value, since all correspondence, which is the soul of business, is carried on through the Post Office.

Working Hours of the Post Office

The hours during which postal work is done at every post office and the times at which mails are delivered and closed, are very clearly notified there. The business hours are fixed with due regard to local convenience and work is stopped exactly at the time fixed. Excepting on holidays, the general time table of work at a Post Office is as follows:—

For Inquiries and References—	From 7 to 8 a. m. and from noon to 5 p. m.
For Sale of Stamps and Stationery—	At any time at which it is open to public.
For Registration, Insurance, Parcels, and V. P. Parcels, and for granting Certificate of Posting—	From 7 to 8 a. m. and from noon to 5 p. m. (On Saturday till 3 p. m.)
For Money Orders, British Postal Orders, Savings Bank business, and Cash Certificates—	From 10 a. m. to 3 p. m. (On Saturdays till 1 p. m.)

For ordinary and express telegraphic Money Orders—	At any time between 8 a m to 6 p m when work is going on
For Receiving telegrams—	The same as above

All Sundays, New Year s Day, Good Friday, King s Birthday, and X'mas are Post Office holidays Besides the above, holidays are also observed on a number of public festivals in different provinces

The work of the Post Office mainly consists of —

1 Inland and Foreign Post
2 Money Orders and Postal Orders
3 Savings Banks
4 Cash Certificates and Postal Insurance
5 Telegraph and Telephone services

Postage Stamps and Stationery—Postal and Telegraphic charges are paid by affixing postage stamps, which together with Post Cards, Envelopes, and Wrappers (for News Papers and Packets) are sold at all Post Offices Stamps of small value—$\frac{1}{4}$ anna, $\frac{1}{2}$ anna, $\frac{3}{4}$ anna, 1 anna, $1\frac{1}{4}$ annas, and 2 annas—embossed Envelopes and Post Cards are also sold by postmen throughout India.

Stamps are of the following value:—

$\frac{1}{4}$ Anna	2 Annas	6 Annas	5 Rupees
$\frac{1}{2}$ Anna	$2\frac{1}{2}$ Annas	8 Annas	10 Rupees
$\frac{3}{4}$ Anna	3 Annas	12 Annas	15 Rupees
1 Anna	$3\frac{1}{2}$ Annas	1 Rupee	25 Rupees
$1\frac{1}{2}$ Annas	4 Annas	2 Rupees	

Stamp Booklets containing 16 postage stamps of 1 anna and $1\frac{1}{4}$ annas respectively are sold at Re 1 and Rs 1 4 0 each at most Post Offices

For the exclusive use of Government Offices special stamps bearing the word "Service" or "on

H. M S" are issued by the Treasuries to Government Officials

Air Mail Stamps of the value of 3as 6as and 12as are also available now at most Post Offices

Embossed Envelopes are of two sizes square ($4\frac{7}{8}'' \times 3\frac{7}{8}''$) and commercial ($6'' \times 3\frac{1}{2}''$), they bear a printed stamp of 1 anna, or 1 a 3p, and are sold for the same prices

Registration Envelopes are of three sizes and are sold at the following prices —

$7\frac{1}{2}'' \times 4\frac{1}{2}''$	at 0 4 9 each
$9'' \times 6\frac{1}{2}$	at 0 4 0 each
$14\frac{1}{2}'' \times 5\frac{1}{2}''$	at 0 4 3 each

These envelopes are lined inside with cloth and are much stronger than ordinary envelopes They are specially meant for insured covers

Post Cards are of two kinds Inland and International. They measure $5\frac{1}{2} \times 3\frac{1}{2}$ inches and bear stamps of 9 pies and 2as each respectively

For Official use Inland Post Cards with the word '*Service*' printed on the impressed stamps are also used.

Wrappers bearing a $\frac{1}{4}$ anna stamp are sold at the following prices :—

1 for 0-0-7	4 for 0-2 4
2 for 0-1-2	5 for 0-2 11
3 for 0-1-9	6 for 0 3 6

They are used for sending Newspapers and Packets by either the Inland or Foreign Post. Additional stamps should be put to cover the extra weight.

Reply Coupons—The sender of a letter to a foreign country (member of the Postal Union) can pre-pay the *reply* by enclosing an International Reply Coupon. The addressee on presenting it at any post office of his country will be entitled to

receive stamp or stamps equal to the postage on an ordinary letter from that country to India They are sold at—

(1) $2\frac{1}{2}$ annas each for Great Britain and British Possessions and the Colonies

(2) 4 annas each for other Union countries

Payment of Postage—The postage on Cards, Registered Newspapers, Packets and Parcels must be prepaid by the senders Also, Post Cards must bear the full postage Letters may be sent as 'bearing', that is the Postage being unpaid or insufficiently paid by the sender Addressees are charged on delivery with double the amount due in such cases

Franking—The Postage on official and private Postal articles may be prepaid by impressions made by franking machines, for the use of which a licence has to be obtained from the Head of the Circle in which the applicant resides

The Inland Post

Postal Articles—The following are the articles of the Inland Post —

1 Post Cards,	4 "Blind Literature" Packets,
2 Letters,	5 Registered Newspapers,
3 Book and Pattern Packets,	6 Parcels

Post Cards

Kinds—Post Cards are of two kinds—*Single* and *Double* or *Reply*

Postage—A Single Post Card requires on it a stamp of 9 pies a Double or reply Post Card the same stamp on each part

Other rules—Post Cards, Single and Reply, of private manufacture can be used provided that the postage is prepaid in full, and that they are not more than $5\frac{7}{8} \times 4\frac{1}{8}$ inches or less than $4 \times 2\frac{7}{8}$ inches, and of the same thickness as those issued by the Post

Inland Postage Rates—(including Ceylon and Portuguese India)

Post Cards		Letters		Book and Pattern Packets		Blind Literature Packets		
Single	Reply	Not exceeding 1 tola	For every additional 1 tola or its fraction	For the first 2½ tolas	For every additional 2½ tolas or fraction thereof	Not exceeding 80 tolas	Exceeding 80 tolas, but not exceeding 200 tolas	Exceeding 200 tolas but not exceeding *300 tolas
¼ anna	½ annas	1 anna	½ anna	½ anna	¼ anna	½ anna	1 anna	1½ anna
								*Exceeding 300 tolas but not 400 tolas—2 annas

Registered News papers (Prepayment Compulsory)			Parcels (Prepayment Compulsory)			
			Not exceeding 440 tolas		Exceeding 440 tolas to 1000 tolas (Registration Compulsory)	
Not exceeding 10 tolas	Exceeding 10 tolas, but not exceeding *20 tolas*	For every additional 20 tolas or *fraction of it*	For the first 40 tolas or less	For every additional 40 tolas or *part of it*	Exceeding 400 tolas, but not exceeding 480 tolas	For every additional 40 tolas or fraction of it up to 1000 tolas
¼ anna	½ anna	½ anna	4 annas	4 annas	Rs 3	4 annas

Registration fee	*Insurance fee*			
For every Post Card, Letter, Packet, or Parcel	Not exceeding Rs. 100	For every additional Rs 50 up to Rs 200	After Rs 200, for every additional Rs 100 up to Rs 1,000	Over Rs 1,000, for every additional Rs 100 or less
3 annas	3 annas	1 anna	2 annas	1 anna

Office Nothing should be attached to a Post Card except :—

(a) Postage Stamp (or stamps),

(b) A slip (not more than 2"×¾") bearing the *name and address of the addressee, completely* gummed to the Card,

(c) A similar slip with the name and address of the sender and

(d) *Drawings, Photos, Pictures, etc, on very* thin paper completely pasted to the Card.

If a Post Card is posted without stamps of the *full amount it is sent to the Dead Letter Office* (D L O) to be destroyed

Business Reply Post Cards and Envelopes.

"*Business Reply cards*" and "*Business Reply Envelopes*" can be sent without prepayment of postage *which will be collected in cash from the addressee on* delivery

They are used by business men when they want that the customers may be put to no expense for replying to the letters sent to them

The following are the conditions to be fulfilled :—

1 Persons desiring to use such Cards and Envelopes *must apply to the Postmaster of the office* to which the Cards or Envelopes are to be returned.

2 The *fee* for the permit is Rs 10, payable in advance The permit will remain in force for one year

3 Such Cards and Envelopes must be of the same size, form and quality as allowed for those of *private* manufacture

They should show on the address side the following particulars —

(a) Printed name and address of the person or firm to whom they are to be delivered,

(b) The permit number

(c) The name of the Post Office issuing the permit,

(d) The words "*Business Reply Cards* or "*Business Reply Envelopes*

(e) The words ' No Postage Stamps Necessary, Postage will be paid by Addressee

The Rates of Postage are the same as on ordinary Post Cards and Envelopes

Letters

Postage—The rates of postage on letters are as follows —

For the first one tola or less	1 an
For every *additional* one tola or less	$\frac{1}{2}$ an

Unpaid and Insufficiently paid Letters—(a) A letter posted unpaid is charged on delivery with double the postage, and a letter posted insufficiently paid is charged on delivery with double of the deficiency

(b) *Unpaid letters*, with or without covers, *if not securely closed* by the sender are forwarded to the D L O for being destroyed.

Book Packets

Postage—For the first $2\frac{1}{2}$ tolas or less	$\frac{1}{2}$ anna
For every *additional* $2\frac{1}{2}$ tolas or less	$\frac{1}{2}$ anna

Contents—A Book Packet may contain any of the following things —

(a) Newspapers, Magazines etc, Books, Photos, Pictures, Drawings and Maps

(*b*) *Business Papers*, such as, Invoices, *Bills of Lading*, Railway Receipts, *Statements of Accounts*, Insurance Policies, etc., *not being of the nature of a personal letter*.

(*c*) Circulars, that is, printed letters and notices.

(*d*) Written letters of old date having already passed through the post and served their purpose.

(*e*) Manuscripts for the press.

N B —A Book Packet should not contain Paper money, that is, things like Postage or ... Stamps, Currency Notes, Hundis, Bills of Exchange, *Cheques, Bank Notes, etc.*

Size —A Book Packet may be of any shape, but its size must not be more than 2′×1′×1′. When, however, it is in the shape of a roll, the length must not exceed 2½ feet, and its diameter, not more than 4 inches.

Packing A Book Packet may be posted without a cover, or in an open envelope, or in a cover which can be easily removed for the purpose of examining the contents at the Post Office.

Penalty —If a Book Packet is found to contain anything forbidden by the rules of the Post Office, or exceeds the fixed size, or is improperly packed, it will be charged on delivery at the rate of letter or parcel, whichever may be less. Postage Stamps already put will of course be taken into account for this purpose.

For an *Unpaid or Not Fully Paid* Book Packet the receiver will have to pay double of the amount due.

Pattern and Sample Packets

Postage—For the first 2½ tolas or less ½ an.
, every additional 2½ tolas or less, ½ an.

Contents —A Pattern Packet may contain :—

(*a*) True patterns and samples of trade, *not having any saleable value*,

(*b*) Objects of natural history, such as dried and preserved animals

Size and Weight—The size of the Pattern Packet must not exceed 2 × 1 × 1 and weight is limited to 200 tolas

Packing—Patterns should be sent without a cover or in open or removeable covers Samples of seeds, drugs, articles of glass, liquids, oils etc, must be very carefully packed in such a way that the contents may be easily examined at the Post Office if desired

(Other rules are the same as for Book Packets)

"Blind Literature" Packets

Postaeg—	For a packet not exceeding 80 tolas	½ a
	Exceeding 80 tolas but not 200 tolas	1 a
	Exceeding 200 tolas but not 300 tolas	1½ as
	Exceeding 300 tolas but not 400 tolas	2 as

Contents—Papers of any kind, magazines and books *printed in "Braille"* or other type and specially meant for the use of blind persons, alone can be sent

Conditions—(a) The packet should contain articles specially meant for the Blind and should not contain anything in ordinary writing or printing

(b) On the outside should appear the words "*Literature for the Blind*", together with the name and address of the sender

(c) The packet should be posted either without a cover, or in an open cover

(d) The size should not exceed 2′ × 1′ × 1′, and the weight not more than 400 tolas

(Other rules are the same as for Book and Pattern Packets)

Registered Newspapers

Definition — A registered newspaper is that publication which consists of political or other news, or current topics with or without advertisements, provided that it is published in numbers at intervals of not more than 31 days and that it has a *bonafide* list of subscribers

Conditions —1 The newspaper should be registered in the Office of the Post Master General

2 The word 'Registered' along with the registered number should be printed just above the address

3 The postage should be paid in stamps

4 The newspaper should be posted without a cover or in an open cover or wrapper, at the place, where it is published

5. No other paper should be enclosed with it except its supplement.

Postage —Up to 10 tolas in weight $\frac{1}{4}$ a
Exceeding 10 tolas but not exceeding 20 tolas $\frac{1}{2}$ a
For every *additional* 20 tolas or less $\frac{1}{2}$ a

Parcels

Rates of Postage —(A) For parcels not exceeding 440 tolas —

Weight	Amount	Weight	Amount
Up to tolas—	Rs a p	Up to tolas—	Rs a p
40	0 4 0	280	1 12 0
80	0 8 0	320	2 0 0
120	0 12 0	360	2 4 0
160	1 0 0	400	2 8 0
200	1 4 0	440	2 12 0
240	1 8 0		

(B) For Parcels exceeding 440 tolas—

Weight	Amount	Weight	Amount
Up to tolas—	Rs a p	Up to tolas—	Rs a p
480	3 0 0	760	4 12 0
520	3 4 0	800	5 0 0
560	3 8 0	840	5 4 0
600	3 12 0	880	5 8 0
640	4 0 0	920	5 12 0
680	4 4 0	960	6 0 0
720	4 8 0	1000	6 4 0

Contents —Anything may be sent in a parcel except the following :—

(a) An explosive, dangerous, or filthy substance.

(b) Any living creature, except Bees

(c) Gold coins or bullion exceeding Rs. 700 in value

(d) Opium and such other drugs prohibited by law.

(e) Any sharp instrument not properly protected

NOTE.—A parcel may also contain only *one* written paper of the nature of a letter, addressed to the receiver of the parcel

Weight and size—Up to 440 tolas or $5\frac{1}{2}$ seers a parcel may or may not be registered, beyond 440 tolas upto 1000 tolas or 12 seers it *must be registered.* It should be packed in a convenient size; the length should not exceed $3\frac{1}{2}$ feet and length and girth combined not to exceed 6 feet

Packing.—A parcel must be packed, according to its nature, in a reasonably strong case, cover, or wrapper, so as to preserve the contents from damage and loss.

Other Rules —In the case of a registered parcel the postage and the registration fees must be prepaid by putting necessary stamps to the parcel

Every parcel must be presented at the window of the Post Office. A parcel found in a letter box is treated as a registered parcel, this fee being charged from the addressee

A registered parcel is delivered to the addressee only when he has signed a receipt for it.

Registration

Object—By registration postal articles become more secure, as they pass through the hands of special officers under special precautions. But in ordinary circumstances the Post Office is not responsible for any loss or damage of a registered parcel. In special cases the Post Master General may grant compensation up to Rs. 25

Fee—The fee charged for registration is 3 annas for each postal article, in addition to the ordinary postage charge, to be prepaid by means of stamps affixed to the article When the article is presented at the window a receipt will be given for it.

A registered article is delivered to the addressee only when he has signed a prescribed receipt, presented by the Postman, for it

Special Acknowledgment.—By putting a stamp of 1 anna besides postage and registration fees, the sender of a registered article can get an acknowledgment of the correct delivery of the article signed by the addressee.

Compulsory Registration—The following things have always to be registered when sent through the post :—

1 A parcel exceeding 440 totals

2 An article to be insured.

3 An article containing Stamps, Cheques, Hundis, Notes, Bills, etc.

4 A parcel which requires Customs Declaration

5 Any article on which the word 'Registered' may have been written
6 A registered article, which is reposted
7 Any value payable article

Insurance

Object—Insurance makes the Post Office responsible for the loss of or damage to an article, caused during the course of transmission

Registered letters and parcels, and 'value payable' registered letters and parcels can be insured at a Branch Post Office upto the value of Rs. 600, and at a General or Head Post Office upto Rs. 3,00'. The insured value should not exceed the actual value of the article Under this rule, securities, legal documents, papers of value, etc, are all regarded as having a real value

Fees—In addition to postage and registration charges, the following are the fees for insurance :—

	Rs	a	p.
1. When the value does not exceed Rs 100	0	3	0
Exceeding Rs. 100 but not exceeding Rs. 150	0	4	0
Exceeding Rs. 150 but not exceeding Rs 200	0	5	0
2. After Rs. 200, for every additional Rs. 100, or part of it, up to Rs. 1,000 ...	0	2	0
3. After Rs. 1,000, for every additional Rs 100	0	1	0

All these charges have to be prepaid by means of stamps.

Packing—Every article for insurance must be carefully and securely packed in a strong cover, and sealed with wax bearing a private mark, which should not be of a current coin or of mere lines. All the seals must be of the same kind of wax and must have the same mark.

The amount for which an article is insured must be clearly written in words and figures on the cover The sender's name and address must also be written at the left-hand lower corner, or on a separate slip attached to the article The article must be presented at the Post Office window and a receipt obtained for it

Delivery—An article insured for Rs 250 or less is delivered through a postman If insured for a higher sum, it is delivered only at the Post Office, information of its arrival being sent through a postman

The sender receives free of charge, an acknowledgment of delivery, signed by the addressee

Compensation—The amount of compensation is determined by the actual amount of loss or damage, and it never exceeds the insured value For a claim of compensation it has to be proved that the loss or injury was caused on account of neglect of Post Office

No compensation is, however, payable in the following cases —

1 Loss or damage due to loose or improper packing

2 Mis delivery owing to wrong or incomplete address

3 Once an article has been delivered to the addressee and he signed the receipt for it

4 If the sender fails to give notice of loss within 3 months from date of posting

5 For loss of halves of currency notes, if the other halves have not been given over to the Post Office

6 Loss arising from the nature of an article

7 If the article sent is a prohibited one or some fraud has been made by the sender or the receiver.

Compulsory Insurance—For coins, bullion, jewellery, currency notes, articles of gold or silver, insurance is compulsory

If any of these things is sent uninsured and the facts become known to the Post Office, it will be either returned to the sender or delivered to the addressee on payment of one rupee as penalty, *and the Post Office will be free from all liability.*

Value-Payable Articles

The value payable (V P) system is very useful to traders as well as to public, because the buyer pays for an article at the time of delivery of the article itself or of the relative Bill or the Railway Receipt, and the seller recovers the value of the article through the agency of the Post Office.

Letters, Packets and Parcels (after being registered) can be sent as V. P. articles, provided that the sum to be recovered from the receiver does not exceed Rs 1,000, and does not include a fraction of an anna.

Declaration—The sender of a V. P article has to declare that it is being sent as the result of a *bonafide* order received by him

Manner of posting—The article must be presented at the Post Office with the prescribed printed form duly filled and signed by the sender.

And, on the article itself must be written :—

(a) In the upper-left hand corner, the letters "V P." together with the amount to be recovered, in words and figures.

(b) In the lower left-hand corner, the name and *full address of the sender.*

Prohibited Articles—There is a general prohibition against the sending of the following articles by the Inland Post —

1. Any indecent printing, painting photograph card or book, or any postal article having on it an indecent, seditious, or offensive marks, designs, etc

2 Any explosive, dangerous, filthy or noxious substance

3. Any sharp instrument not properly protected

4. Any living creature (except Bees under special rules)

5 Gold coin or bullion of a value exceeding Rs. 700.

6 Opium, cocaine, and other similar drugs

Note—If a postal article is found to contain any of the above things it will be returned to the sender. If it is only suspected to contain such things, it will be marked "[illegible]", and will be opened in presence of the addressee at the post office of destination.

Express Delivery—Unregistered letters, post cards and Book Packets may be sent by post for express delivery, on the following conditions:—

(1) The words "*Express Delivery*" must be written on the address side, or a printed label with these words be pasted.

(2) Extra Postage stamps of 2 annas should be affixed to each post card or letter.

(3) This fee and the usual postage must be prepaid in full.

Window Delivery—Any person living within the ordinary delivery area (except at the towns of Bombay, Calcutta, and Madras) can have his articles delivered to him loose at the window free of any charge. The addressee has to make a written application for this arrangement. A bag furnished with lock and duplicate keys, however, can be

supplied to the applicant on payment of its cost and a monthly fee of Re 1 chargeable in advance

A 'window delivery ticket' will be issued to the applicant and it will entitle him to this service at any Post Office

Late Letters—Even after the mail is closed, an article of the *letter post* can be sent by that mail if presented within 15 minutes, and stamped with a late fee at –

½ anna for an unregistered article ,

2 annas for a registered article

Train Letter Boxes—Letters, cards and small packets may be posted in Train-Letter Boxes, if there is no letter-box on the platform or within a mile of the station

If there is a letter-box on the platform, the article to be posted in the Train Letter-Box must bear *extra one anna stamp* as late fee

NOTE—No article should be posted in the Train at the stations of Bombay, Calcutta and Madras, otherwise they will be detained

Certificate of posting—To make sure that articles entrusted to servants for posting have actually been posted, a certificate may be obtained from the Post Office, as follows –

(1) It must be written in ink, headed with the words ' *Certificate of Posting*," and should contain an exact copy of the addresses on the articles

(2) The number of articles for which the certificate is required must be written in words at the foot of the certificate Not more than three articles should be entered in a single certificate, which should bear a stamp of ½ anna

(3) It should be presented, (during the hours fixed for this purpose) along with the articles, to the officer on duty, who will then put the post office Date stamp on the certificate

Recall of posted Articles—Inland Letters Cards, Book and Pattern Packets, Registered News papers and Parcels, while in course of transmission, can be re-called subject to the following conditions —

(1) A written application must be forwarded by the sender to a high Postal or Government authority, such as the Director General of Post and Telegraph, the Head of Local Government, etc

(2) With the application should be sent a statement (in a sealed cover) of the reasons why recall is desired

(3) A *fee* of Re 1 for each article must be paid

Note—Foreign registered articles of the *letter mail* and also registered parcels which have not been despatched from India, may also be re called

Redirection—An inland article, which cannot be delivered owing to the addressee being elsewhere, may be redirected free of charge to another Post Office for delivery to the addressee, provided that—

(1) In the case of an unregistered article, it has not been opened, and has been either returned to the postman or reposted at the place of delivery

(2) In the case of a registered article it has been returned to the postman without signing the receipt

Note—If notice of arrival of an article has been once given to the addressee, it will not be redirected

When a *parcel* is redirected it is charged with further postage *at half the pre paid rate*, for each redirection

A registered article of which delivery has been taken for the first time, and which has not been opened, can be registered when reposting, free of charge

Post Restante—As travellers and tourists have no definite addresses, articles sent to them are addressed with the addition of some such words as "To be called for", "To wait arrival", etc They are commonly known under the French phrase 'Post Restante articles (Pron Post Restant) meaning post to wait till called for Such articles are kept in the Post Office to which they are sent as follows —

(1) For three months in the case of the chief big ports of India

(2) For one month in all other cases

A V P article is kept for 7 days only

Identification Cards—This system has been very recently introduced to help tourists, travelling representatives of firms, and other persons who cannot easily prove their identity in the towns which they visit With the possession of these cards they will be able to obtain delivery of registered and insured articles and receive payment of money orders without having to produce witnesses as was often the case now

(1) These Cards can be obtained at any Head Post Office by literate persons who are well established or well known in the place they live

(2) The card will contain a photograph of the holder (supplied by him) his full description, and his signature It will remain in force for 3 years from the date of its issue

(3) The fee for such a card is Re 1

The Dead Letter Office (D L O)—*Articles which* cannot be delivered due to illegible or incomplete *addresses, also articles which are refused and do not* bear the address of the sender, are forwarded to the *Dead Letter Office* (at Lucknow *for U P*) *of each* province

Here further attempts are made to trace the receiver or the sender within a certain fixed period, *after which they are destroyed or otherwise disposed* of.

Complaints Against Post Office—Letters containing complaints against the Post Office must be fully pre paid They must be addressed to the Postmaster of the office concerned

If the complainant is not satisfied with the action taken by the Postmaster, then he should write to the Superintendent of Post Offices of his area Complaints on matters of special importance should be sent direct to the Postmaster General

Test Questions

1 Name the articles of Inland Post, and give the rates of postage for each

2 Suppose you send a Post Card with only one pice stamp on it what will happen to it at the Post Office ?

3 What can be the cheapest way of sending a Book and a Magazine to a friend of yours ? How will you pack and post them ?

4 What is a Book Packet and a Pattern Packet, what things can and cannot be sent as such ?

Give the rules of the *size*, *packing* and *weight* of these Packets

5 Define ' Blind Literature", and give the general rules of posting such packets

6 You have to send a parcel of clothes to a person in Delhi It weighs 6 seers How will you pack and post it, and what will be the expense ?

Suppose the same parcel is to be sent to Calcutta, will the postal expense differ ?

Can you send through the Post Office a parcel weighing 10 seers 8 chataks ?

7. What is the use of Registering an article, what things *must* be registered ?

8 A Registered Letter containing currency Notes was sent through the post, but the notes were lost. Can you claim compensation from the Post Office ? What was the correct course to be followed ?

9 Does the Post Office pay compensation in all cases for damage or loss to *insured* articles ? Point out the cases when this is not possible

10 The Postman brings a registered parcel to you addressed in the name of your brother who is not at home Can you take delivery of it ?

What will you do to send it to your brother (*a*) when opened by you, (*b*) when not ?

CHAPTER V (*contd.*)

(B) Foreign Postage Rates

Countries	Letters: Not exceeding 1 oz.	Letters: For every additional 1 ounce	Post Cards: Single	Post Cards: Reply	Printed papers each packet: For every 2 oz. or fraction of it	Business papers each packet: Not exceeding 10 oz.	Business papers each packet: Every additional 2 oz.	Samples each packet: For every [illegible] or less
(a) The [illegible]	As. 3½	As. 2	As. 2	As. 4	As. ¾	As. 3½	As. ¾	As. *¾
(b) Other parts of the World [illegible] by the Foreign [illegible] —	3½	2	2	4	¾	3½	¾	*¾

Registration	Insurance: Value not exceeding £12	Insurance: Every additional £12 or fraction thereof up to £60	Parcels (Through British Post Office): By rail (Not exceeding 20 lbs.)		By [illegible] & O. S. N. Co. (Exceeding 11 lbs. but not 50 lbs.)
				Rs. a.	
3 Annas for each article. 3 Annas more for a special Acknowledgement	4 as. 6 p.	4 as. 6 p.	Not over 3 lbs.	1 8	12 As. for each lb. or fraction thereof
			Over 3 lbs. to 7 lbs.	2 12	
			Over 7 lbs. to 11 lbs.	3 15	
			Over 11 lbs. to 20 lbs.	6 3	

The Foreign Post

The 'Union Countr —An international *P tal Union* has been established in order to make the procedure and rates of postage uniform amongst the various countries of the world The countries which have joined this Union are called 'Union Countries

Note —Ceylon and Portuguese India are included in the Inland Post of India

'Correspondence —For purposes of the Foreign Post the term 'correspondence means the following :—

1 Post Cards
2 Letters
3 Printed Papers (including Books and News papers)
4 Business Papers (Legal and commercial documents)
5 Samples
6. 'Blind Literature packets

Post Cards—*International Post Cards single* and Reply, are generally used for Great Britain and other Union Countries They can be obtained at most post offices But Inland single Post Cards can also be used for this purpose, whether additional stamps are put on them or not double the deficiency being charged on delivery But on Inland Reply Post Cards sent to a *foreign* country *full* postage stamps must be affixed to both halves

Postage —On a single Foreign Post Card 2 as

For Burma—Single Post Card 1 an

Reply Post Card 2 as

Letters—*Postage* —(1) For Great Britain Northern Ireland, Egypt and other British Possessions—2½ annas for each 1 ounce or part of it, and 2 as for every next ounce or part of it

For Burma—For the first tola $1\frac{1}{4}$ as
For every next tola or fraction of it 1 an

(2) For other countries—

$3\frac{1}{2}$ annas for the *first* ounce, and 2 annas for every next ounce or part of it

Size and Weight—A letter should not exceed 35 inches in length, breadth and thickness taken together and $23\frac{1}{2}$ inches in any one direction If it is in the shape of a roll, it can be 39 inches in length plus twice the diameter, and 31 inches in any one direction Weight must not exceed 4 pounds 6 ounces

Transparent or Outlook Envelopes—Envelopes of this type can be sent uninsured to foreign countries, provided —

1 the transparent panel forms part of the envelope and is parallel to the longest side of the address,

2 it does not interfere with the putting of post office date stamp,

3 the panel is perfectly transparent and the address is quite legible through it

Such envelopes are also used for inland purposes

Note—If postage on foreign letters is unpaid or is not fully paid, double the deficiency will be charged on delivery which should not be less than 5 centimes in the money of the country

Printed Papers—Printed Papers include Newspapers, Books, Visiting Cards, Proofs of printing, Photographs, Pictures, Drawings, Maps, Catalogues, Notices and Advertisements, etc

Size and Weight—(The same as for Letters)

Weight, for Great Britain and Ireland, is limited to 5 lb, for other countries to 4 lbs 6 ozs

Note—A single volume of a book may weigh up to $6\frac{1}{2}$ lbs.

Postage—$\frac{3}{4}$ anna for every 2 ounces or part of it

For Burma—$\frac{3}{4}$ an for the first 5 tolas

$\frac{1}{4}$ an for every next 5 tolas or less.[1]

Business Papers — Business Papers include open Letters and Post Cards of old dates, Legal Papers, Deeds, Bills of Lading, Invoices, Documents of Insurance, Pupils Exercises, Articles for Newspapers, etc

Size and Weight —(The same as for Letters and Printed Papers)

Postage—For a packet not exceeding 10 ounces . 3½ annas

For every additional 2 oz or less . ¾ anna.

For Burma— The same as on Printed Papers.

Sample Packets —They must be *bona fide* samples of merchandise, not having any saleable value A sample should *not* bear any writing except the name, profession and address of the addressee as well as of the sender. It may, however, show the date of despatch, the Telephone number, the Telegraph Address, Code used, and Trade Marks

Samples should be placed in bags, boxes, or envelopes, which may be easily opened for inspection purposes

Size and Weight (i) For Great Britain and Ireland size should not be more than 2′×1′×1′.

Weight should not exceed 1 lb. 2 oz

(ii) For other Union countries size is the same as for Letters and Business Papers

In weight it must not exceed 1 lb 2 oz

Postage — ½ as for every 4 ounces or part of that weight

¾ an for every additional 2 oz or less

(For Burma the same as before.)

Mixed Packets—'*Mixed Packets* means that Printed Papers, Business Papers and Samples can be enclosed in the same packet.

Postage—(1) *If it contains Business Papers*—

For the *first* 10 oz ... $3\frac{1}{4}$ annas.

For every next 2 oz. or less ... $\frac{3}{4}$ anna.

(2) *If it contains Printed Papers and Samples only*—

For the *first* 4 oz ... $1\frac{1}{2}$ annas.

For every next 2 oz. or less ... $\frac{3}{4}$ anna.

(NOTE.—All postage must be fully prepaid on all these papers and packets.)

Total weight should not exceed 5 lbs for Great Britain, etc., and 4 lbs. 6 oz. for other Union countries.

"Blind Literature" Packets

NOTE.—These packets are of the same nature as explained in the Inland Post.

Postage.—For a packet not exceeding 2 lbs. in weight ... $\frac{1}{2}$ anna.

For every additional 2 lbs. or less, upto 10 lbs. in weight ... $\frac{3}{4}$ anna.

Beyond 10 lbs. upto 11 lbs. ... 3 annas.

NOTE.—Postage on such packets must be fully prepaid.

Registration—*Postage*—3 annas for each article, to be prepaid in stamps.

For Special Acknowledgment, 3 annas more in addition to the postage and registration fees.

Insurance—Only registered Letters and Parcels can be insured, provided—

(1) They contain valuable papers and documents, such as Notes, Bonds, Securities, etc.

(2) The value to be insured does not exceed £40, or Rs. 600.

(3) The *insured value* does not exceed the *real value* of the contents of the letter or parcel

Postage—To British Possessions and certain other countries—

When the value insured does not exceed £12	4 annas 6 pies
For every additional £12 or part *of it up to £60*	4 annas 6 pies

Acknowledgment Fee—3 annas for each registered article.

Foreign Parcels

Customs Declaration—The sender of a foreign parcel has to make, for custom purposes, an accurate mention of the nature and value of the contents in full detail *This is done on a special form obtainable* free at any post office, and it is pasted to the parcel

Postage—(*A*) *Parcels not exceeding 20 lbs in* weight are forwarded as mails to a British Post Office at the following rates :—

	Rs	a	p.	
Not over 3 lbs	1	8	0	Via Gibraltar
Over 3 lbs , but not over 7 lbs	2	12	0	
" 7 " " " 11 "	3	15	0	
" 11 " " " 20 "	6	3	0	

(*B*) Parcels which exceed 11 lbs but do not exceed 50 lbs (the maximum weight) *may also be forwarded from* Bombay through the P and O. Steam Navigation Co , *at 12 as for each pound or less*

V P Parcels—Such parcels can be sent to Great Britain and a few other places, provided the amount to be recovered from the addressee, in respect of each article does *not exceed Rs* 600 and does *not* contain a fraction of an anna

A posting fee of 2 annas must also be paid by the sender of a V P article by affixing necessary stamps on it

NOTE—The Money Order fee is the same as for Inland V P. parcels.

Foreign V P Parcels can be insured under the rules relating to Insurance

Test Questions

1 What is the foreign rate of postage for each of the following —

(a) Post Cards , (b) Letters (c) Printed Papers (d) Samples ?

2 What is meant by 'Business Papers' in the Foreign Post , what is the rate of postage ?

3 Give general rules of size and weight regarding foreign Samples, 'Blind Literature' Packets and Printed Papers

4. What fees are payable for (a) Registration and (b) Insurance of Foreign articles ?

5. You have to send a Parcel to South Africa , it weighs 8 lbs. What expense will be incurred if it is sent (a) Un Registered, (b) Registered and insured ?

6 Can Parcels be sent otherwise than through the Foreign Post , What is the limit of weight in both Cases ?

7 Write short notes on —

A 'Union Country,' Outlook Envelopes, Mixed Packets, Customs Declaration, and International Post Cards.

CHAPTER VI

Money Orders and Postal Orders

A Money Order (M/O) is an order from one post office to another for the payment of a sum of money to a specified person

The person who sends money by a Money Order is called the "*Remitter*", and the person who receives the sum of a Money Order is known as the "*Payee*"

(A)—Inland Money Orders

Limit of value —The amount of a single money order must not exceed Rs 600, except in cases of the Government and must not include a fraction of an anna

Rates of Commission—

For a sum not exceeding Rs. 10	2 annas
Exceeding Rs 10 but not exceeding Rs 25	4 annas
Exceeding Rs. 25 but not exceeding Rs. 35	6 annas
Exceeding Rs 35 but not exceeding Rs 50	8 annas.
Exceeding Rs 50 but not exceeding Rs 60	10 annas
Exceeding Rs. 60 but not exceeding Rs 75	12 annas
Exceeding Rs 75 but not exceeding Rs 85	14 annas
Exceeding Rs. 85 but not exceeding Rs. 100	Re 1

(and so on for other sums)

How to send a M O—The remitter must fill in ink a *money order form* (*supplied free by the post office*) giving the amount and name and address of the payee, and sign it *On the 'acknowledgment' portion* of the form he must write his own address together with the amount and the name of the payee On the '*Coupon*' portion he may write any message he wishes to convey to the payee

The form duly filled in, along with the sum and the commission fee must be presented at the post office window and a receipt obtained for it

When the money order reaches the payee he will have to sign the acknowledgment If he is illiterate, he will put his thumb-impression in the presence of a witness who will sign the money order This acknowledgment is then delivered to the remitter in due course

Telegraphic Money Orders—When it is desired to send a money order by Telegram, the remitter must write across the form "*By Telegraph Ordinary,*" or "*By Telegraph Express,*" as desired

Charge—The charge for such Money Orders is the commission at the usual rate added to a telegraph charge for the actual number of words used in advising the remittance Besides, a supplementary fee of 2 annas is charged on each Telegraphic Money Order.

No —A Telegraphic Address or Code Word cannot be used in a Telegraphic money order.

Indian Postal Orders—It is only recently that Postal Orders have been issued by the Postal Department for use within India They are of the following values —

8 as.	Rs. 4	Rs. 7½
Re. 1	Rs. 4½	Rs. 8
Rs. 1½	Rs. 5	Rs. 8½
Rs. 2	Rs. 5½	Rs. 9
Rs. 2½	Rs. 6	Rs. 9½
Rs. 3	Rs. 6½	Rs. 10
Rs. 3½	Rs. 7	

Broken amounts up to 7 as (without a fraction of an anna) can be made up by affixing to a Postal Order any two postage stamps

The poundage or commission charged in respect of each order is 1 anna.

How to send—The person sending a Postal Order must fill in ink the name of the payee and name of the Post Office where it is to be paid It is always safer to "cross a Postal Order, when payment will be made only through a bank.

The purchaser of the Order should retain the counter foil after having filled in the details carefully The counter foil has to be produced whenever it is desired to make enquiries in the event of the Order being lost or mis-delivered

If an Indian Postal Order is not presented for payment *within 6 months from the last date of the month of issue* a charge of one anna will be made *After one year a postal order becomes value less*

(B)—Foreign Money Orders

(1) **Rupee Money Orders**—These are money orders, expressed in rupees, and can be sent to certain *fixed countries and places only as named in the* Postal Guide Rules are mostly the same as for Inland money orders but the *rates of commission are ½ times higher than those charged for inland money orders*

(2) **Sterling Money Orders**—Money orders expressed in £ s d and limited to a sum of £40 at one time can be sent to the United Kingdom and some other European countries

Rates of Commission—Not exceeding £1 4 as

For each additional £1 or less up to £5 . 3 as

Note—If the sum exceeds £5, the charge will be [illegible] for each complete sum of £5 and for the remainder the same as above

(3) **British Postal Orders**—A Postal Order is a very convenient means of sending small sums to a place in the British Empire

British Postal orders for fixed sums (ranging from 6*d* to 21*s*) can be purchased at most Post Offices in places where there is a large European population or a Cantonment Broken amounts up to 5*d* (without a fraction) may be made up by affixing to the Postal Order unused Indian or British Postage stamps, not exceeding three in number

NOTE —The rate at which Indian money is converted into British money or *vice versa* has to be ascertained from the Post Office as it is often changing

Poundage—The charge made by the Post Office in respect of each Postal Order is called Poundage It differs with the amount of the Order as follows —

Amount of Order—	*Poundage*—
From 6*d* to 2*s*. 6*d*	$1\frac{1}{2}$ anna
From 3*s* to 15*s*	$2\frac{1}{2}$ anna
From 15*s* 6*d* to 21*s*	$2\frac{1}{2}$ annas

How to send—The purchaser of a Postal Order has to fill in the name of the person to whom the order is payable He may also mention the name of the Post Office at which the amount is to be paid, otherwise the Order will be payable at any office desired by the payee

NOTE —A Postal Order may be '*crossed*' when it shall be payable through a bank only

The purchaser should also fill in the counter-foil, tear it off, and keep it with himself

Late Fee—If a British Postal order be not presented for payment within 6 months from date of issue, a late fee at the same rate as poundage is charged, and it is paid by putting stamps to the back of the Order

NOTE.—The purchaser can obtain refund of the value of an unused Br Postal Order (but not poundage) at the rate of exchange at which it was purchased, on presenting the Order and the counterfoil at the Post Office of issue

The Air Mail Service

The increasing use of aeroplanes has en[illegible] the *Postal Department to transmit by air-routes* [illegible] *of* the articles of Inland and Foreign Posts This arrangement is known as the Air Mail Service

Letters, Post Cards, and Packets can be sent by air *on payment of special air mail fees* Such *articles* can be registered They cannot, however, be insured except for Burma and Ceylon Parcels cannot be sent by Air-Mail A blue label should be affixed to each article on the left top corner of the address side

Air Fees—*Inland*

(i) For a Post Card	½ an (plus ordinary postage)
(ii) For a Letter or a Packet	1 an for each tola (plus ordinary postage.)

Foreign

Country	Post Card (inclusive of Ordinary Postage)	Letters and Packets (in addition to postage)
	Rs. a p	Rs. a p
(i) Burma	0 1 6	0 1 6 Per tola
Ceylon	0 1 3	0 1 0 Per tola
Portuguese India	0 1 3	0 1 0 Per tola
(ii) 1 Great Britain and N. Ireland	0 6 0	0 14 0 (per every ½ ounce)
2 Egypt & Sudan	0 6 0	0 14 0 (per every ½ ounce)
3 Palestine and Iraq	0 6 0	0 14 0 (per every ½ ounce)
4 Australia	0 6 0	0 14 0 (per every ½ ounce)
5 New Zealand	0 6 0	0 14 0 (per every ½ ounce)
6 Union of S. Africa	0 6 0	0 14 0 (per every ½ ounce)
7 Malaya	0 6 0	0 14 0 (per every ½ ounce)
8 Hongkong	0 6 0	0 14 0 (per every ½ ounce)

Air-Mail Money Orders—(1) *Inland Money Orders* may be sent by air mail, by writing the words "By *Air-Mail*" in red ink across the form

Fee—1 anna for each money order is charged in addition to the usual Commission This is paid by affixing postage stamps to the Money Order form

(2) *Foreign Money Orders* may be sent by air-mail on payment of an air fee in stamps for each money order as noted below :—

The words '*By Air-Mail*' must be written.

For Burma and Ceylon	...	$1\frac{1}{2}$ as
Other countries		6 as.

The Blue Label—A blue air mail label, obtainable free from the Post Offices, must be affixed in the *left hand top corner* of the address side of all articles meant for the Air-mail On articles addressed to Foreign countries the name of the particular *air-route* should be mentioned in ink just near the blue label.

If the above procedure is not adopted the articles are liable to detention.

The fee for the air route indicated must *be prepaid in full*, otherwise the article will be sent by the ordinary route and not by the air-route

Air-Mail Telegram-Letters

At all telegraph offices in India inland Telegrams are accepted for being transmitted first by telegraph to Karachi or Calcutta and then posted from there as air mail letters for countries in the west or east as the case may be

Such telegrams may be written in plain language or code words. Those meant for countries in the west should have 'PAV KARACHI' (and if registered 'PAV R KARACHI)', after the name and address Similarly, in the case of those meant for countries in the East the indication will be 'PAV CALCUTTA'

Charges—The charges payable on such telegram-letters are calculated at the inland rates (according to ordinary or express) *plus* the air-mail fee *in addition to* the usual letter-postage If the message is registered this fee will also be paid

Internal Air-Mail Services

The following air-mail services are operated twice a week in connection with the Imperial Airways Karachi London service —

(i) *The Indian Trans-Continental Air-ways Ltd*, connecting Rangoon Akyab, Calcutta, Allahabad, Cawnpore, Delhi, Jodhpur and Karachi

(ii) *Tata Sons, Ltd*, connecting Madras, Hyderabad (Deccan), Bombay, Ahmedabad and Karachi

(iii) *Indian National Airways Ltd*, connecting Lahore, Multan, Jacobabad and Karachi

Inland articles, both registered and unregistered (but not insured articles or parcels) can be transmitted between any two air stations by the above internal services In addition to the ordinary postage the following fees are charged :—

Fees—For Post Cards	6 pies
Letter or packet upto 1 tola	1 anna
For every additional tola or fraction thereof .	1 anna

Air Mail to Ceylon

Air mail correspondence for Ceylon is transmitted by the Karachi Colombo air mail service The words "India-Ceylon must be written with the address

The fee charged is as follows —

On letters or packets— 1 an per tola or part of it.	In addition to ordinary postage
On Post Cards—½ an each	

Air Mail to Africa

Mails for the Union of South Africa Sudan, Nigeria and most other parts of Africa (except the Equatorial Africa) are accepted for despatch by air from any aerodrome in India They are sent from Karachi every Wednesday and Saturday

Fees—For letters and packets, per ½ ounce is as follows —

To Uganda, Kenya, etc.,	7 as.
To Belgian Congo, Rhodesia, etc ,	8 as.
To Union of S Africa	9 as.

On Post Cards it is only 4as to all places.

Air Mail to the U. S A

Air mails for all parts of this country are now accepted at any Post Office in India for despatch by the Imperial Airways up to England and then further transmission by sea to New York The words 'India—England—U S A' must be written on such correspondence

Fees—For a Post Card 5 as. (inclusive of postage)

For a Letter or Packet 10 as. per ½ oz. (in addition to postage)

Air Mails to S. America

Air mails for almost all the chief states in S America are despatched from Karachi by the 'Imperial Airways' to Brindisi (in Italy), Marseilles (in France) and Stuttgart (in Germany) for onward transmission therefrom to destinations, by the French and German weekly services

Fees—Rates of fee differ for different states or group of them. For some of the chief states they are as follows —

	For Post Cards (inclusive of postage)	For Letters and Packets—per ½ oz (in addition to postage)
		Rs. a. p
Columbia, Equador, Br Guiana, Peru	8 as.	1 4 0
Brazil	Rs. 1 1-0	2 14 0
Argentine Republic, Chile, Paraguay, Uraguay	Rs. 1 4-0	3 6 0

CHAPTER VII

Post Office Savings Banks

(And Postal Investments)

Object.—The Savings Banks at Post Offices have been opened by the Government to enable people to deposit their small savings and thus inculcate the habit of thrift. These Savings Banks are not to be treated like ordinary banks for keeping 'Current accounts'. The Accountant General can close a Savings Bank account of a person, if he has reason to believe that it is being used for a purpose for which it is not intended.

Time for Deposit.—All Post Offices that are Savings Banks are open to receive deposits daily with the exception of Sundays and Post Office holidays, from 10 A. M. till 3 P. M. (till 1 P. M. on Saturdays), unless otherwise notified.

Who may deposit.—Any person may deposit money in a Post Office Savings Bank on behalf of :—

(*a*) himself,

(*b*) a minor relative,

(*c*) a minor, of whom he is a guardian

(*d*) a lunatic, of whom he is the manager or guardian

Note.—Only one account can be opened by one person in his own name. Minors and women whether married or single can also open accounts in their own names if they so desire provided the money deposited is their own property or earning.

Two or more persons cannot open a joint account, except in the name of a known firm or partnership.

Amount of Deposit.—No sum less than 4 annas, and no sum that includes a fraction of an anna, can be deposited. The total deposit in the course of each year (from 1st April to 31st March) should not exceed Rs. 750, after deducting the amounts withdrawn.

Also the balance in the account at *any time* should not be more than Rs 5 000, excluding the interest *for the current year.*

Note —1 The total amount at one's credit may be increased beyond the above limits, if part of it is invested in Government Securities, *e g* Cash Certificates

2 Money, with interest, is repaid to the person who opened the account in his or her own name, but in the case of *minors*, money will not be repaid, *during the period of minority* to any one except the guardians

How to open an Account. —Any person wishing to open an account has to apply to the nearest Post Office stating his name and address, *together with the father's name and caste (not for Europeans)* He has to sign a declaration form admitting that the rules of the Savings Bank have been read by (or read to) him, that he accepts them as binding upon him, and that he has no other account opened in his own name at any other Post Office. He has then to give his specimen signature to be kept in the Post Office for future comparison

Note —If he is unable to write he should affix his mark or seal to *the declaration, in the presence of a witness who will attest it*

When the first amount has been deposited the depositor gets a Pass Book, (free of cost) in which entries are made and initialled by the Post master and also stamped with the Office seal The depositor will have to sign a receipt for the Pass Book

'*Pardanashin*' *Ladies* can open accounts in their own names, or through their husbands (*if married*) or agents, who will have to produce a *letter of authority* in the prescribed form, and to sign the declaration that the depositor understands and accepts the rules

Further Deposits —*Every time money is desired* to be deposited in the Bank it should be taken or sent to the Post Office along with the Pass Book, in which the amount will be entered and stamped with the date-seal. If the account be opened at a Branch Post

Specimen page of a Pass Book

Date	P O Date Stamp	Amount of each deposit or withdrawal (in words)	Amount deposited	Amount withdrawn	Balance at Credit	Initials of the post Master
			Rs a p	Rs a p	Rs a p	
1934 3rd April,		Deposited ten rupees	10 0 0		10 0 0	A B.
5th May		Deposited twenty five rupees 8 as	25 8 0		35 8 0	A. B.
3rd June		Withdrawn five rupees.	...	5 0 0	30 8 0	A. B.
4th Aug.		Deposited fifteen rupees	15 0 0	..	45 8 0	A. B.

Interest.—Interest is allowed on complete sums of rupees at 2% (or $2\frac{1}{2}$% sometimes.) It is calculated on the lowest balance at the credit of an account on any date between 4th day and the close of the month. This amount of interest is added once a year after the 15th June.

Illustration.—Interest on the amounts shown in the given Pass Book would be calculated thus :—(Assuming that it is being added on 31st March of the following year.)

Amounts.		Months.		
Rs. 10	×	1	=	10
,, 35	×	0	=	0
,, 30	×	2	=	60
,, 45	×	8	=	360
				430

Now interest on Rs 430 @ 2 per cent per annum for one month will come to Rs 0-11-6 This sum will be added to the balance and carried *forward for* next year

Postal Investments.

Cash Certificates —Post Office 5-year cash certificates are obtainable at any Post Office doing Savings Bank business as follows —

Face value	Purchase price		Face value	Purchase price	
Rs	Rs	a	Rs	Rs	a
10	8	13	1,000	881	4
20	17	10	2,000	1,762	8
50	44	1	3,000	2,643	12
100	88	2	4,000	3,525	0
500	440	10	5,000	4,406	4

Note—The purchase price is often changing according to the conditions of the money market

The purchaser of *Cash Certificates has to fill in* and present an application in the prescribed form obtainable from the *Post Office*

The amount shown *on a Cash Certificate is* payable after full five years from the date of issue, on presentation of the Certificate at the *Office* where it is registered The back of a Certificate has a table showing the amounts repayable by the Post Office for different periods after the first year But no *interest* is paid if it is desired to demand the payment *within a year from* the date of purchase of a certificate

No person, whether sole holder or joint holder, can purchase Cash Certificates of the total nominal value of more than Rs 10,000, and he has to make a written declaration to this effect.

Government Securities —The Post Office provides full facilities for enabling persons to purchase and sell Securities issued by the Government of India for its loan bearing interest at $3\frac{1}{2}$ per cent or more This investment can be made from the money already deposited in the investor's Savings Bank account or from extra money The purchaser has to fill up a special application for the purpose, supplied by the Post Office, and mention therein the particulars of the loan in which he wants to make the investment Another application is used when it is desired to sell off the securities, which must be handed to the postal authorities along with the application The amount so invested by an individual during any one official year is limited to Rs 5,000 and the total aggregate to Rs 22,500

Safe Custody.— If a person has got a Savings Bank account he may tender Government Securities, purchased through the Post Office, for safe custody by the Accountant General of Post and Telegraph No fee or commission is charged for this work of purchase, sale, or safe custody So long as the Government securities remain in the custody as above, the interest on them is credited to the investor's Savings Bank account, and it is also free from Income tax

Postal Insurance —The Postal Department also enables all Government Civil Servants as well its own employees to insure their Lives with the Post Office There is a Postal Life Insurance Fund and Policies, both Whole Life and Endowment, are issued for a fixed term The one great advantage of this insurance scheme is that premiums are deducted from the salaries of the Policy holders.

Test Questions

1 What is a Savings Bank why has the Post Office op n such Banks

2 State the general rules as to who can open a Sav Bank account and what sums can be deposited and how ?

3 Describe the procedure of withdrawing money from a Savings Bank—(a) for self (b) for a Parda nashin lady, and ( ) for a nor

4 Can a Post Office Savings Bank account be transferred h w

5 Describe clearly how to *l se* and *re fen* a Savings Bank account

6 What is meant by a 'Dead Account, when does a Savings Bank account become '*dea l* ?

7 Do you know how and at what rate (generally) interest is calculated on Savings Bank accounts ? Explain.

8 What is a Post Office Savings Bank Pass Book, and what is its importance, how is it entered ?

9 Prepare a specimen page of a Pass Book with at least five entries extending over five months Calculate interest on the various amounts, at the close of the year

10 What are Postal Cash Certificates, how are they useful as a means of investment ?

11 Describe as many forms of Postal Investment as you have learnt

CHAPTER VIII

Rapid Means of Communication

Formerly, the means of transport and communication were very defective. There were few good roads and the universal use of carts and pack-animals, such as bullocks, horses and mules, made transport a very slow and tiresome process. It was also most unsafe. At the same time there was not much of real trade and business and it was usually confined to only nearby places. It is true at least of the daily business requirements of people of those days. This was so because the things required for the satisfaction of human wants were not only few in number and simple in quality but also they were produced or made mostly in the neighbourhood of the people.

On the contrary, modern business has increased both in volume and variety as well as distance. The following are some of the special features of present day business: —

(a) The market for almost all goods and commodities has now become world wide.

(b) The number and variety of goods has not only increased but a good many perishable articles have been included, for example, fruits and vegetables, eggs, fish and meat, fresh milk and butter.

(c) Prices and rates change daily and even hourly in some cases.

To avoid loss due to delay in disposing of the perishable articles and also to take advantage of changing favourable prices it became therefore, absolutely essential to complete transactions at a moment's notice. Accordingly, some rapid means of transport and communication were discovered by thoughtful people.

First of all, the **Means of Transport** were very greatly improved during the 17th Century when certain discoveries and scientific inventions took place

With the use of Steam Power for running Engines, Railways and Steam-ships were built As a result of this, carriage of men and goods became many times faster and easier

Later on, petrol-oil began to be used in running engines, so motor-cars and lorries came into use for transporting passengers and goods between distant places.

Lastly, since the last Great War we have got the Aeroplanes which fly in the air with such a great speed that a distance which formerly took months to cover can be traversed now in weeks and even hours

Next, electricity gave to the world certain extraordinary means by which messages could be sent at an astonishingly rapid speed People living at distant places in a country, or even different countries, can now communicate with each other in as short a time as is humanly possible These rapid means of communication have played a very important part in helping the growth of modern business

The chief means of **Rapid Communication** are — (1) Telegrams (2) Telephones, and (3) The wireless-system

Note—The *Wireless Telegram* or *Radio-grams* and *Radio-phone* are nothing but much improved forms of the above two systems. Instead of electricity they are operated through Radio Waves. Though comparatively of recent origin they have also begun to be widely used

Telegrams may be *Inland* or *Foreign* We propose to deal here with the first

Inland Telegrams

Telegrams sent to or received from places in India, Afghanistan and Ceylon are classed as '*Inland*'

Government Departments as well as business firms adopt a brief address for their telegrams It is usually printed at the left top of the Letter papers This address has to be registered at the Telegraph Office for a fee of Rs 20 yearly or Rs 12 half-yearly payable in advance

Charges – Inland Telegrams may be 'Ordinary or Express', the charges for each class being as follows .—

Class	Unit No. of Words	Delivery in India: Unit rate	Delivery in India: Each additional word	Delivery in Burma: Unit rate	Delivery in Burma: Each additional word	Unit No. of words	Delivery in Ceylon: Unit rate	Delivery in Ceylon: Each additional word
		Rs. a	Rs a	Rs. a	Rs a		Rs a	Rs a
Ordinary	8	0 9	1 0	1 2	0 2	12	1 0	0 2
Express	8	1 2	0 2	2 4	0 4	12	2 0	0 3

Late Fee—An Express telegram is accepted on payment of a late fee during the hours when the sending, receiving or the intermediate office is closed Re 1 is charged for each closed office which is required to deal with the telegram

Cancelling a Telegram—If the sender of a telegram wishes to cancel it before transmission, he can do so , and the charges, *less a fee of 4 as* will be refunded

Note—Telegrams to be called for by the addressee at the office should be marked T R for the Telegraph Office, and G P for the Post Office

Reply pre-paid—If the sender wishes to prepay a reply, he should write ' *Reply Paid*' and the amount in the space provided on the form These words

within inverted commas will be charged as only one word A Reply Form will be given to the addressee who may use it for any inland message within two months

Repeating Telegrams —If the sender so desires, a telegram can be telegraphed *back* from office to office on payment of one-half the usual *charge*, fraction of a half anna being counted as a half anna

Similarly, if the accuracy of a telegram is doubted by the receiver, it may be repeated by paying the charge at the usual rate for the number of words so repeated This money will be refunded should it turn out that the original was wrongly telegraphed

Multiple Address Telegrams—A telegram can be delivered at two or more addresses in the same area on payment of ordinary charges for the total number of words in the body and the addresses, plus 4 annas for every hundred words in each copy beyond the first.

State Telegrams—All officials of the Government (except those on leave), Registrars of Universities, and heads of certain special societies or organizations can send such telegrams, provided they relate solely to the business of the Government

The word "State" must be written by the sender, and it is counted as one word

The charge is the same as for private telegrams

Immediate Telegrams—Certain Government Officials having been specially authorised by the Governor-General-in Council, on occasions of emergency and great importance, can ask the telegraph authorities to stop all other telegrams until their particular telegram is passed It should bear the word "Immediate" The charge is double that of a Express telegram

Raj Telegrams—A *Raj* telegram is one sent by an official of an Indian State on some business of that

state Such telegrams are marked '*Raj*' by the sender This is counted as one word The charge is the same as for private ones but it is paid in service stamps

Greetings Telegrams Greetings and messages of congratulations may be sent by telegram at reduced rates on occasions of (1) Christmas and New Year, (2) Dewali (3) Id (4) Confirment of Titles, (5) Weddings (6) Birthday anniversary and (7) Success in Examinations

The charge is 6 annas for the ordinary telegram and 12 annas for the express, each consisting of not more than six words as follows :—

(*a*) 4 words in the addressee's name and address

(*b*) 1 word as sender's name

(*c*) 1 word for the message which should be selected from the list of *stock phrases given in the Guide (Clause 3/6 B)

Each additional word in items (*a*) or (*b*) will be charged at 1 anna for ordinary telegram and 2 annas for Express In the message itself no additional word is allowed

*Some of the phrases are being reproduced here —

For Christmas and New Year—A Merry Christmas and Happy New Year

Respectful wishes for a very Merry Xmas.

Love and greetings for a Happy Xmas.

A Happy New Year to you all

Best of luck during the New Year

Hearty Greetings for the New Year

For Dewali—Blessings for Dewali and New Year

Wish you every prosperity and success in the New Year

Heartiest Dewali Greetings to you

Dewali Salam

For Id—Id Mubarak

Id Greetings to you

Best wishes for a happy Id

For Birthday—Happy days be ever yours.

Good fortune favour you

Many happy returns of the day

For Titles, Examinations, Weddings, etc—Hearty congratulations on well merited honour

Warmest congratulations

May this honour be the forerunner of many more

May God bless the Union

Wish you a happy and pro perous wedded l fe

Rejo ced to hear of your success Congratulations

De Luxe Telegrams—In such Greetings telegrams the sender may use his own words instead of the stock phrases given above The special instruction= LX=(which is not charged) should be written before the address A fee of 2 as more is charged in addi tion to the usual charge according to Ordinary or Express

Press Telegrams are those addressed to editors of newspapers and are sent at special rates (given below) subject to the following conditions —

(1) That it is addressed to or from a newspaper, the name of which has been registered with the Telegraph Office

(2) That it contains only news intended for publication in registered news papers

(3) That it is written only in plain language, intelligible to the transmitting Offices

Note —In Press Telegrams exchange rates and market prices are allowed at reduced rates

Charges for Inland Press Telegrams for delivery in India are as follows —

Class	Unt No of words	Unt rate	Each additional s x words
		Rs a	Rs a
Ordinary	40	0 8	0 1
Express	40	1 0	0 2

Semaphoric Telegrams are those which are exchanged with ships at sea by *means of semaphore* signals at particular ports Every such Telegram

must bear the special instruction SEM (which is charged for as one word) just before the address They must be expressed either in *English* or by means of groups of letters of the International Code of Signals

The charge for such telegrams is the usual charge for Inland telegrams plus 8 annas to be paid by the sender when sent to a ship and by the addressee when received from a ship

Duplicating Telegrams—Business telegrams are usually duplicated that is two or three copies of every telegram are taken before sending it to the telegraph office A *Triplicate Telegram Book* is generally used for this purpose three copies being produced in it by means of Carbon papers One copy is sent to the telegraph office the second is enclosed with the *letter of confirmation* and the third remains in the Book for future reference

Confirming Telegrams —*Soon after the despatch* of a telegram a letter is also sent enclosing a copy or writing the actual words of the telegram This is called a letter of confirmation and usually commences with some such words as —

(1) onfirming our telegram of this date

(2) We sent you a telegram at 8 A M to-day as per copy enclosed

(3) ' We wired you this *morning* as follows —

Example —Suppose we have to condense the following message into a telegram—From the Bengal Paper Mills Ltd Calcutta to the Art Printing Works Delhi We received your order No 34 for 50 reams of *superior 32 lbs paper yesterday* and in reply have to inform you that the full quantity is not ready with us just yet We shall however take only a week to supply you the whole lot Please let us have your clear instructions in this regard It would appear as —

To { *Art Printing*
{ *Delhi*

can	*supply*	*50*	*reams*	*superior*
after	*a*	*week*	*await*	*instructions*

From —*Bengal Paper.*

NOT TO BE { *The Bengal Paper Mills, Ltd.,*
TELEGRAPHED { *Circular Road, Calcutta.*

The confirmatory letter will be written as follows :—

THE BENGAL PAPER MILLS, LTD.,
TELEG. "BENGAL PAPER" CALCUTTA.
TELEPHONE NO. 1331.

Circular Road,
Calcutta, 25th Jan., 1925.

The Manager,
Art Printing Works,
Delhi.

Dear Sir,

We wired you to-day as follows :—

"Can supply 50 Rams superior after a week. Await instructions"—We may further point out that 32 lbs. *Superior Paper* is not ready in our stock in the quantity you require but the whole lot will surely be supplied in a week.

Please let us have your clear instructions in this regard.

Yours faithfully,
The Bengal Paper Mills, Ltd

NOTE —Printed Postal Forms required for various purposes as described in the foregoing chapter can be obtained free from any Post Office one or two at a time. Books containing 50 forms each can also be purchased at a cost of 2 annas per book.

Test Questions

(Inland Telegrams)

1 Name as many rapid means of communication as you know of and point out the peculiarities of each.

2 How should a Telegram be written? how are words counted?

3 What are the rules of counting words, figures, etc. in a telegram? how many words will be counted in each of the following cases?

(a) B. L. Bhargava The S. S. Victoria

(b) Krishna Swarup's To-day twopence

(c) C. L. Mazumdar Esq. Rs. 100 50 lbs

(d) B/3207 G. L. O.—91 35/57

4 What is a Telegraphic Address? How is it useful?

5 What is the charge for telegrams in each of the following cases:—(a) Express, (b) Ordinary, (c) Late Fee, (d) Cancelling a telegram?

6 Condense the following message into a suitable telegram:—

"Buyers Ram Dayal and Sons Khurja Sellers The Swiss Watch Co Madras Dear Sirs,—We shall be pleased to be supplied with a copy of your recent price list (illustrated) as we intend stocking a large number of low priced watches to suit the requirements of students and the general public. We shall deem it a favour if you quote us specially. Yours faithfully."

7 Write short notes on—Reply Telegrams, Semaphore Telegrams and Greetings Telegrams.

8 What do you know of Press Telegrams? Describe in full.

9 What is a Multiple Address Telegram? How are telegrams repeated?

10 How are telegrams duplicated and confirmed? Write a short letter and a telegram in connection with your cancelling an order for certain goods. Give some reasons for it.

CHAPTER VIII -(Continued)

Foreign Telegrams (Cablegrams)

Telegraphic connections with foreign countries have been secured by means of Cables (strong ropes of wire) spread in the bottom of the seas and oceans, hence a foreign telegram is generally called a 'Cablegram'

Such telegrams are subject to the regulations laid down, by the *International Telegraph Convention* to which India is also a party These countries, however, do not accept any responsibility on accuont of foreign telegrams

Classes—There are usually four classes of foreign telegrams —

1 Ordinary or full rate 2 Urgent, 3 Deferred, and 4 Daily letter telegrams

Urgent Telegrams are those which can be sent only to countries specially mentioned in Section XXIV of the Guide The special instruction 'D has to be inserted by the sender before the address, and it is counted as one word

The charge for such telegrams is double of that for Ordinary Telegrams

Deferred Telegrams are those accepted on condition that they will be transmitted after full rate and press rate telegrams They are charged at half the rate for ordinary telegrams

Deferred telegrams must be expressed wholly in plain language (see further) which may be either French or the language of the country of origin or

that of the country of destination This fact is denoted by writing the special instruction = LC = which is charged as one word

Declaration by the Sender – The Sender of a Deferred Foreign telegram has to sign on the telegraph form a declaration stating that the text is expressed wholly in plain language and is used in the same meaning as appears on the face of it The language is also mentioned

Daily Letter Telegrams in plain language are accepted on any day of the week during working hours, and are delivered to the addressee ordinarily on the morning of the second day They should be written in the manner of Deferred Telegrams The special instruction DLT (which is charged as one word) must be written before the address

The *charge* for them is ⅓rd of that for full rate *telegrams, the minimum being equal to the charge* for at least 25 words They are transmitted after Deferred telegrams

Empire Social Telegrams— 'GLT" Social Telegrams conveying greetings family news or personal affairs can now be sent from India to all Empire countries at the fixed rate of Rs 3 6 for 13 words or less (including the indicator) Each additional word is charged at 4½ as

De Luxe Telegrams—Telegrams relating to happy events or greetings may be sent to certain foreign countries on an artistic form in an envelope equally beautiful The charge is 4 as more in addition to the usual charge for an ordinary, urgent, DLT, or Deferred Telegrams

Note—Special forms are provided by Telegraph Offices to be used for cablegrams

Charges —The rates of charge differ for each country and can be ascertained from the Postal Guide

(Section XXIV) For some of the principal countries, however, the rates are given below –

Countries	Ordinary (per word) Rs. a. p.
Europe—	
United Kingdom	0 13 0
France	1 3 0
Germany Norway	1 4 0
Italy	1 5 0
Spain and Portugal	1 4 0
Switzerland	1 4 0
Denmark	1 3 0
Belgium	1 2 0
Holland	1 2 0
Russia	1 5 0
North America—	
Canada	1 11 0 to 3 4 0
U S A	1 11 0 to 2 3 0
Asia—	
Japan	2 3 0
Malaya Peninsula and St. Settlements	1 3 0
Union of S Africa—	1 15 0
Australia—	2 4 0
South America—	3 4 0 to 3 10 0

NOTE.—For Code telegrams the charge is $\frac{2}{3}$ of the above rates for countries of the British Empire, and $\frac{3}{5}$ for others.

Language of Foreign Telegrams —Cablegrams may be written either (1) in Plain Language, (2) in Code Language or (3) in Secret Language

1. *Plain Language* is one which consists of words, figures, and letters giving an intelligible

meaning, such as English, French, or any other *principal foreign language* which should be written in Roman characters

Each word should not consist of more than 15 letters, figures or signs The names of the place and country, province or district to which a cablegram is sent, are counted as single words, however long they may be

2 *Code Language* is composed either of artificial words, or of real words not used with the meaning of the language to which they belong *It may consist* of both real and artificial words

Telegraphic Codes—To save money in sending foreign telegrams, Codes have been devised A Telegraphic Code is composed of real words or mere group of letters, which can be pronounced but have no intelligible meaning Each word in a Code stands for phrases and even sentences These words are *mostly derived from the principal European* languages—English, French, German, Italian, Spanish, Protuguese, Dutch and Latin—and each word consists of not more than 10 letters Proper names in Code word telegrams are allowed only in their natural sense

NOTE—*Several Codes have been published, e g., the A B C.* Code, the Bentley's, the Lieber's, etc The A B C (5th Edition) Code is most widely used The particular Code used is generally indicated at the Headings of printed letter forms of most business firms.

The words in the A. B C Code (over 25,000 in number) are arranged alphabetically, and each word is preceded by a consecutive number consisting of only 5 figures

This alphabetical arrangement of each Code-word coincides with the alphabetical arrangement of the important word in the phrase or sentence placed against the Code word

The following extracts from Codes are intended to give the student an idea of what a telegraphic Code is like

Attention

03416 Affect = is (are) receiving careful attention

03417 Affecting = will give prompt attention

03418 Affection = careful attention is necessary

February

15821 Favour = February, 1

15822 Favourable = February, 2

Goods

66008 Globular = Goods were not shipped

66009 Glomerate = Goods are all landed

66010 Gloomily = Goods are not landed

Letter

21495 Land = in your letter of ——

21496 Landing = in your letter of ——

Remittance

32750 Refero = send at once remittance promised.

32751 Refino = remit the proceeds by telegram

How to use a Code —Suppose we have to send the following message to a foreign country—

'*Send at once remittance promised in your letter of February 1 careful attention is necessary*

Pick out the important words in the message: they are—'Remittance, 'Letter, 'February and 'Attention

Now look up in the Code (the above extracts for our purpose) under each of these *word headings*, and

find out the Code words which stand for each appropriate phrase in the message The coded telegram will then appear as follows —

REFERO LANDING FAVOUR AFFECTION

The receiver of the telegram by consulting a copy of the same Code will come to know the real message. *This reverse process of finding out the meaning of a coded telegram is known as decoding a telegram*

Cypher Telegrams — Absolute secrecy cannot be kept when Cablegrams are written in Code words since any one in possession of a copy of the same Code can make out the meaning of the message very easily Therefore, another method, called the *cypher system* of writing foreign telegrams has been devised It renders a telegram absolutely secret

A cypher telegram is composed of either groups of letters or of figures, which do not form any intelligible words, and have a secret meaning But combinations of both letters and figures, or of Plain Language Code words, or cyphers are not allowed in the same telegram

Every group of 5 letters or figures is taken as one word, plus one word for any excess Every separate *figure, letter, commercial sign, decimal point, full stop, etc*, is charged as one complete word But when these signs and marks form part of a group, each is counted only one letter or figure

How to write —The telegram should first be written in Code words, *and then it can be changed into* Cypher with the help of a *Key word* This is a word of *ten different letters*, (or merely a group of ten different letters) selected by the persons who have to exchange secret messages

Example —Suppose *the telegram in the foregoing* illustration is desired to be turned into Cypher,

with the help of the key-word 'PRODUCTIVE,' the letters of which should be numbered as—

P R O D U C T I V E
1 2 3 4 5 6 7 8 9 0

Now, referring to the Code we find that the number against the first word 'REFERO is 32750' In place of each figure of this number put a letter from the key word as indicated by its corresponding figure. We get—'ORTUE'

Against the second code-word 'LANDING', the number is '21426' This number will be changed into 'RPDRC

Next, the number against 'FAVOUR' is '15821', and against 'AFFECTION' it is '03418' Replaced by letters from the key-word these numbers will be changed respectively into 'PUIRP' and 'EODPI'

Thus the telegram in Cypher would consist of—

ORTUE RPDRC PUIRP EODPI

The other person on receiving this telegram will understand the real message by just reversing the process The above message in plain lanquage will cost Rs 12 3-0 (15 words at 0 13-0) if sent to a place in Great Britain , but in Code-words it will cost only Rs 2-8 0 (4 words at 0 10 0)

Private Codes—Sometimes, firms having to send telegrams regularly to their branches or agencies in foreign countries, on a particular business, compile their own codes With the use of these private codes complete secrecy can be kept, and at the same time there is much saving of money combined with great facility of business

Radio Telegrams are those transmitted to *ships at sea* (fitted with radio-telegraph apparatus) or to

places abroad, through the main coast-stations in India

The address in a radio telegram to a *ship at sea* (written on yellow forms) should include :—

(a) Name and address of the addressee,

(b) Name of the ship, prefixed by the word "steamship"

(c) Full name of the coast station from which the telegram is to be transmitted

Charge — For radio telegrams sent to *ships at sea* is 13 as per word For ships of the Royal Indian Marine it is 6 as per word

(A supplementary charge has also to be paid in addition to the above charges)

Test Questions

(*Foreign Telegrams*)

1 What is a cablegram why is it so called?

2 In what languages can Foreign telegrams be expressed? Explain each

3 What is a telegraphic Code what purpose does it serve?

4 What is a cypher Telegram, how is it effected? Explain clearly by an example

5 What do you know of —

Private Codes A key word, Deferred Telegrams, The A B C Code?

6 How are words counted in Foreign Telegrams—(a) Plain (b) Coded, (c) Secret?

7 Describe how to use a Code

8 Name the classes of Foreign Telegrams and explain each briefly

9 What are radio telegrams? Describe all that you know

10 What are Greetings Telegrams? Name their variety and the conditions applicable to each, with rates of postage

CHAPTER IX

TELEPHONES

The telephone is an instrument that communicates speech by means of electric waves It was invented in the year 1877

A telephone has great advantage over every other means of communication between persons living at a distance from each other It brings them practically face to face and enables them to settle important matters as easily and quickly as by personal talk The telephone has proved of exceptional benefit to businessmen, because transactions can be settled and many a point discussed with ease, rapidity, and at less expense

The instrument itself consists of two parts—the Receiver and the Transmitter, and the telephones at different places are connected with each other through electric wires

Kinds—Telephones are of two kinds

(1) Wall Telephone where the instrument is attached to the wall

(2) Table or Desk Telephone, where it is setup on a table

Connections—The lines of connections may be—

(a) *Direct*, that is, two buildings or offices in the same building being connected directly

(b) *Internal or Local* that is, connections within a town or 'Exchange Area

(c) *External or Trunk*, that is, connection of one Exchange Area with another

Most of the big cities in India have got local telephone arrangements and all the capitals of the provinces important commercial centres, and hill stations are connected by Trunk lines

Fee—An application has to be made to the Telegraph Office for the installation of a telephone, the fee for which is Rs 20 monthly or Rs. 192 annually. For trunk calls a special fee is charged which varies with distance and the duration of the call.

How to use a Telephone

In Direct Connection—The person using the telephone should first take the Receiver from the hook, on which it hangs, and put it to his ear, and then he should bring his mouth near the Transmitter. A bell *will ring at once at the other place, and somebody* there to attend the call should do the same The conversation will thus begin When they have finished their talk each will replace the Receiver in its proper place

In Local Exchange Connection—*To make a call*, lift the Receiver of the hook (or turn the handle in wall-telephones) taking care not to jerk it. This will connect you with the *Central Exchange* where there is an operator to join connections all the 24 hours. Putting the Receiver to your ear ask for the number you want to talk with, do not ask for names Note that the number is correctly repeated by the operator, *and wait with the Receiver to your ear* until the person called begins to speak

To answer a call—When your bell rings, take the Receiver off the hook, put it to your ear, and speak at once *distinctly close to the Transmitter. The lips* should be within about half-an-inch of the mouth-piece. Give out your name first For example, if Rama has ringed you (Hari), begin thus—"Hari speaking, is Ram there?" Do not say "Hullo" or the like.

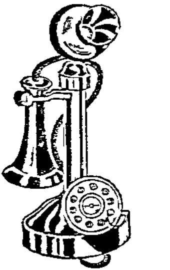
Note—Do not ring in the middle of your conversation, if you do so you will be disconnected If one person leaves his phone to get some information, the other should keep the Receiver to his ear; when the other returns he should speak, and not ring

To close the conversation say 'Good bye' to the person and replace the Receiver on the hook or turn the handle.

In Trunk Lines—To make a Trunk Call ring up the Central Exchange and say "Trunk Call," give out your own number, and then the name of the Exchange and the number you want to be connected with For example, calling from Meerut to somebody in Delhi, you may say "Trunk Call Meerut 129, Delhi 432" These numbers will be repeated by the operator, and you should then hang your Receiver As soon as the operator has obtained the required number, he will ring you up again. You should then begin your talk.

The Automatic System—The telephones used these days give *automatic connections* and the services of the Exchange operator are not necessary. There is a wheel attached to the phone It has ten holes around its border and inside the wheel there is a disk bearing the figures 1, 2, 3 9, 0, so that each of them appears through a hole Suppose we want to be connected with No 5307, in the Exchange Area We shall put our index-figure in the hole where '5' appears, turn the wheel as far as it will go, and then remove the finger The wheel will turn back again Then we shall put the finger in hole of '3', turn it and take off the finger, the same

The Telephone



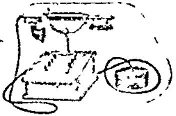
(AUTOMATIC CONNECTION MODEL)

being done for other figures. We shall then be connected with No. 5307; and can, of course, begin our talk. If the line is not already engaged a bell will ring at the phone of the person called, but if it is engaged, a buzzing sound will be heard and the operator will have to wait for sometime until the person spoken to responds. This system exists in big cities like Bombay, Delhi, Calcutta and Cawnpore

When a Trunk Call is desired to be made with the automatic system the speaker has to ring the Central Exchange for the required number.

Phonograms.—Telephone subscribers may telephone messages to a telegraph office for onward transmission as a telegram. In addition to the charges for telegrams an additional fee of 2 annas will be levied for each such telegram.

Foreign Telephone Service—Telephonic connections with European countries had already existed, and now they have been extended to Burma, Ceylon and several other parts of the world Recently, Radio-Telephone Service has been opened with Great Britain and Ireland, some other countries of Europe, Canada and U. S. A., Australia, and South Africa.



The Automatic Telephone (Desk Model)

Charges for call between India and certain principal countries of the world are —

Destination.	For the first 3 minutes	For each additional minutes.
	Rs.	Rs. a.
Burma	16	5 0
Great Britain and N. Ireland	40	13 5
France	44	14 10
Germany	48	16 0
Egypt	60	20 0
S. Africa	75	25 0
Australia	75	25 0
Canada	85	29 5
U. S. A.	85	29 5

Superiority of the telephone.—The telephone is much superior to the telegraph, because—

1. No message has to be written.

2. The speakers can personally discuss matters and settle business transactions, etc.

3. It is much quicker and cheaper.

4. It is a means of educating people in the art of talking briefly, to the point, and courteously.

Instructions for using Phones—1. Speak close to the transmitter, *but not too [illegible]*. Speak distinctly, yet not loudly.

2. Do not jerk the hook, or twist the cord.

3. Attend a call promptly, do not say "Hullo", and be brief in your talk.

4. Always remember the number correctly, if in doubt, refer to the Directory. Learn the correct method of calling out long numbers; *e.g.* 77200 should be called "Double seven two double zero."

5. Do not converse with the operators and be courteous to them.

Record of Message—In the interest of business it is desirable that every message or talk secured on the telephone should be recorded properly by the attendant or office clerk, and it should be filed with the general correspondence.

Telephone messages are generally recorded on special printed forms a specimen of which is given below

TELEPHONE MESSAGE	
Date	Time
From	
Message	
Reply	
	Attendant

The Wireless system—With the discovery of Radio waves the 'wireless broadcasting has begun to play an important part in the lives of almost all peoples of the world Transmitting stations have been established at the principal cities of a country (at Bombay, Calcutta Delhi, Lahore Madras and Lucknow in India at present) and by installing 'receiving apparatus in our homes it becomes possible for us to listen to all sorts of news speeches lectures music etc broadcast from the Stations at fixed hours of day or night

The broadcasting of business news dealing with market conditions and prices is of special interest to tradesmen

For installing a Radio Receiving set a licence fee of Rs 10 annually has to be paid to the Post Office

Test Questions

1 What is a telephone? How is it [illegible] to the [illegible]?

2 Name the kinds of telephones and the systems of connection. [illegible]

3 Describe in general terms how to use a telephone

4. What is meant by 'Exchange Area,' how is a call made with this kind of connection ?

5 Suppose you are living in Lahore and want to phone to a person in Calcutta. Is it possible, how will you get connection ?

6 What is meant by 'automatic connection' ? Explain.

7 Note the points to be observed in using telephones.

8 How will you keep record of a verbal transaction agreed on the phone ? Is the record at all necessary ? Give an example

9 Write a brief note on the 'Wireless system'.

10. What do you know of the 'Foreign Telephone Service ?

CHAPTER X

Duplicating Methods

Modern business is built on the foundations of advertising It is necessary not only to bring to the notice of the buying public the merits of a newly manufactured article but also to keep constant touch *with the customers of an old established firm.* Competition in business has grown very keen and every businessman tries, naturally enough, *to out-do* his rivals Advertising is, therefore, resorted to both through the newspapers and by means of circular letters, prices currents, market reports, special offers, etc., etc

Although a printing press is the best place for getting printed any number of copies of an ordinary matter, yet business papers are generally not printed *at a press owing to the following reasons :—*

1 A printing press is more expensive if only a limited number of copies are required.

2. Proof-correction requires special knowledge

3. Secrecy cannot be kept.

4 A printed letter lacks personal touch, as the same letter is meant for each and every addressee without distinction.

5 It often takes much time.

Still, however, if the number of copies required is very large when the matter runs into several pages, or where coloured pictures, diagrams and designs have to be shown, *the Printing Press* is the only place to get the work done.

To obviate most *of the difficulties pointed* out above, therefore, some other processes have been devised *by* which business papers can be multiplied

almost entirely in the office within a short time The chief Duplicating Methods are —

1. The Manifolding (or Carbon paper method)
2. The Hectograph (or Gelatine method).
3. The Mimeograph (or Stencil method)
4. The Multigraph (or Composing method)
5. The Lithograph (or Stone-writing method).

The Manifolding Process—How to use Carbon-Papers has already been explained in the lesson on '*Methods of Copying Letters*' In combination with the Typewriter Carbon Papers are an excellent means of duplicating business papers

Carbon papers are of several colours—purple, blue, black, green and red They may be '*single-coated*' or '*double coated*,' the latter being used *only* on occasions of special need

We can turn out on the typewriter about a dozen copies at one time, if the sheets of paper as well as the carbons are quite thin Ordinarily, however, not more than six copies should be attempted at a time, repeating the process until the required number is reached

Process—Take five or six plain sheets and interleave them with Carbon-papers, care being taken that *the coated side of each carbon sheet faces the paper which is to receive the impression*. Next, feed them carefully into the machine, and before beginning to type see that they have all been inserted correctly. Then type out the matter in the usual manner.

This method is quite useful when the number of copies required is about 30 to 40.

Note—For further details the reader is referred to the lesson on 'Manifolding' in the author's THEORY OF TYPEWRITING Book I.

The Hectograph—This method, known also as the Gelatine Process, though *old fashioned* is both

simple and cheap. It is very useful for producing 40 to 50 copies of an ordinary pen-written matter, or of small sketches and drawings. It is just serviceable for a small business office. Friendly and other associations, clubs and societies generally make use of this process for printing notices of meetings, programmes, etc.

Necessary things.—A metal tray, some gelatine, and a bottle of Hectograph Ink, are all that is required.

Process.—The gelatine is first melted by placing it in a small tin box in boiling water. It is then *poured into the metal tray which is placed in cold water.* In this way the gelatine spreads out forming a smooth firm surface.

The writing is done on a glazed paper with the hectograph ink. (It may also be typed with a hectograph ribbon, if desired.) The written sheet is then placed, *facing down, on the gelatine,* and pressed over evenly. The gelatine sucks off the ink, leaving the paper nearly blank. Other sheets of paper are then placed, one after another, on the gelatine and the whole surface is pressed *lightly* with a *soft* rubber roller or merely with the palm of one's hand.

Note.—Now, however, the gelatine has been so perfected that it has not to be melted and cooled. It is already made in the shape of a thick smooth firm surface.

The China Slate.—Recently, in place of the gelatine, a kind of slate *made of China clay has come into* general use. This slate has the quality of absorbing ink and it works just like the smooth surface of the gelatine.

Note.—(1) As soon as work is finished, the surface of the gelatine or the slate should be washed off with a sponge and warm water. (2) If the surface of the gelatine becomes uneven it should be re-melted and cooled. (3) If all the ink on the gelatine has been used up and more copies are needed, the same material should be written on again and the whole process repeated as described above.

The Facsimo Duplicator—Since the work of the gelatine process is always unsatisfactory more or less, it is being replaced by a sort of machine called Facsimo Duplicator The matter to be copied is written with facsimo ink and then transferred to a specially prepared substance fixed to a rocking frame of the duplicator Papers to be printed are placed on the printing surface, pressed and removed mechanically This process enables about 80 to 100 good copies to be produced and the work is also much superior

The Mimeograph—By the Mimeograph or Stencil method about a thousand good copies can be obtained from a single stencil It is highly serviceable for big businesses which have to issue very frequently circulars, market reports, prices currents, etc

Things required—(1) A hard steel pen, called the Stylus or Style,

(2) Wax sheets or Stencil Papers,

(3) A steel Slate or a '*file*',

(4) A tube of Stencil Ink,

(5) A bottle of Stencil Varnish, and

(6) The Duplicator

Process—The main thing in this method is the Stencil, which may be 'cut' either with the Stylus pen or on the Typewriter

(*a*) A Hand stencil is prepared by writing with the Stylus, (without any ink, of course) upon a wax sheet placed on the steel slate or the 'file' At the end of this steel pen there is usually a very small cogged wheel, which makes fine cuts into the wax sheet according to the movements of the hand

(*b*) A Type Stencil is prepared as follows —

The first thing is to clean the metal types of the Typewriter, and to remove (or to stop the action of)

the ribbon Then arrange properly the stencil paper and the tissue and backing sheets, and feed the whole carefully into the type machine, so that the tissue-sheet is in the front

Note — 1 The tissue sheet is meant to receive the small particles *of wax struck out by the types while the backing* sheet acts as a hard surface and also prevents creasing of the wax sheet.

2 *The work of typing out the matter should then be done rather* cautiously If any mistake is made in typing or a crease formed in the wax sheet it should be corrected by applying the Stencil varnish on to the affected places.

3 Signatures on a type cut stencil are made by laying the tissue *sheet over the wax sheet and writing the name with the stylus.*

Production of copies – When the stencil is ready, copies may be produced with it on one of the two kinds of apparatus—(1) *The Flat Duplicator,* (2) *The Rotary Duplicator*

The Flat Duplicator—It is usually a wooden box containing a hard resting slate, a printing frame, and an ink-board with a rubber roller It is used as follows —

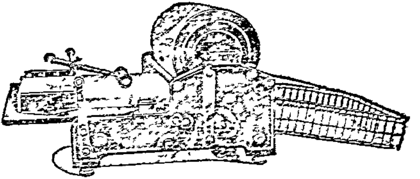
Stretch and clamp the stencil in the printing frame, and place a piece of *blotting paper under it on* the hard slate. *Squeeze* a little ink out of the tube

on to the ink-board, and passing the roller back and forth several times spread it evenly. Now, pass the inked roller over the stencil thoroughly until the ink comes uniformly on the blotting paper. Remove the blotting paper and place instead plain sheets of paper, four or five sheets at a time. Pass the roller once firmly on the stencil, and lifting the frame take off the paper each time it is printed. Go on in this way with all the plain sheets. As soon as ink gets faint, pass the roller over the ink-board.

Note —1. To dry the printed sheets quickly, specially in the wet season, *a Drying Book* is sometime used. It is made up of thin blotting papers. As copies are printed they are placed between its pages. When full, the book is pressed under a weight or in the iron press, if one is there, till the sheets are quite dry.

2. In some Duplicators, *e g*, the Red Seal Duplicator, the printing frame is fitted with a '*diaphragm*', which acts as a protection to the stencil, and enables a greater number of copies being produced. Again, this frame may be self-lifting, that is, each time the roller is passed the frame rises by itself. A large number of sheets are placed under the frame and removed one by one as the frame rises at once after each passing of the roller. This naturally quickens the work of printing copies.

ROtary duplicato



The Rotary Duplicator.—This is a machine consisting of a perforated metal drum and a roller under it, both hanging between the frame of the machine. A small inking-roller fitted inside the hollow of the

drum, spreads ink. On the outer surface of the drum a linen ink-pad is spread. At the right of the drum there is a handle by which the machine is rotated.

The Stencil (*specially made to be used on such* machines) is attached on the outside of the drum. Ink is supplied by another roller from inside. The papers to be printed are placed on the feed board. As the handle is turned each sheet is pushed in. It is gripped between the roller and the drum, and passed on printed to the other side where it falls into a receiving tray. Thus 50 to 60 copies can be printed *per minute, and from a single stencil about* 5,000 copies are possible.

Note.—The above is a very general description and applies mostly to the earlier makes of Duplicators. Great improvements have recently been made rendering the machine self-inking, self feeding and self-drying. They also regulate the margins of the sheets and count the number of sheets printed. Again, *the rotation of the new sorts of* duplicators can be performed by a treadle or by electric motor. On these machines the speed of work is, of course, very greatly increased.

The Gestetner

Self inking and Self feeding Duplicator

The Multigraph.—The Multigraph or Type-setting method is, so to say, a small printing press for private use. It has several advantages over other methods :—

1. Its work is just like a typed matter, but far more superior to it.

2. It is better as well as cheaper than that of a printing press
3. Any number of *originals, not copies* can be produced
4. Corrections and alterations can be easily made
5. It is faster than other methods , copies are counted in the machine
6. It can be worked by any person knowing a little reading and writing

Nevertheless, one point that should be said against it is that its initial cost is rather high, and so it can profitably be utilized only in a big business house where duplication work is much and too frequent

Description and use—We shall here describe the Gammeter Multigraph On the left half of the machine there is a revolving supply drum, containing metal types On the other half is the printing drum *There are also two type keys, one for composing or* setting the types, the other for distributing the types back to their places

As the supply drum is revolved, an indicator points on a bar to letters and figures By depressing the setting key the desired character is carried on to the printing drum Thus each line is composed letter by letter A ribbon $7\frac{3}{4}$ inches wide and 18 feet long is wound round the printing drum over the face of the types, and the machine is then ready to print as many copies as required With each revolution of the drum one copy is printed The ribbon moves on gradually, and as it grows faint pressure is increased to keep the ink uniform.

With a little practice about 300 copies a minute can be turned by hand , and 500 copies or over with self feeding and motor drive arrangements.

The handle is fitted with a *cyclometer* which counts the copies as each is printed

Note—For regular printing instead of the ribbon, an ink pad or a direct inking roller is often used. Electric types and other styles of types can also be used, if so desired, for example, when printing office forms, invitation cards, etc.

When work is finished, each character is sent back to its proper place in the supply-drum by depressing the distributing key

The latest models of multigraph machines are so built that they not only duplicate letters but also print the signatures and addresses, both on letters *and envelopes, in the same operation*

The Lithograph.—This is a process of printing from a special kind of stone, which has the quality of retaining both water and grease. *It is largely* used in India for printing Urdu and Persian scripts. Drawings, sketches, maps, and manuscripts of various sorts are cheaply and quickly produced by this method

Its use.—The writing or drawing is effected either direct on the stone with a *fatty* ink, or it is done *first on a Transfer Paper and then transferred to the* stone

Note.—The Transfer Paper is a kind of specially prepared paper meant for this purpose, but any highly glazed writing paper will also do

After the writing has come on the stone, its surface is kept moist with a damping roller, and printing ink is applied to the writing with another roller. *The ink adheres to the fatty written parts* and not to the moist surface. A sheet of paper is then placed on the stone and pressed over. On removing the paper a copy appears on it

Any number of copies can be printed in this way, since as the ink gets used up it is supplied again with the roller.

Precautions.—The following points should be carefully noted :—

(*a*) Use always *fresh ink*

(*b*) Touch the Transfer Paper only at the corners

(*c*) While writing, place a blotting paper under the hand

(*d*) Drawings, maps, etc., should be pencilled out, before using the ink.

(*e*) As soon as the writing is done, transfer it to the stone, and begin the work of producing copies the same time, if possible

Note—Printing Outfits—Now-a-days many kinds of printing apparatus have been placed on the market, with which ordinary business papers can be duplicated in the office. They contain usually rubber type sets, or types made of some light metal

The matter is composed by hand on a wooden frame which is inked with a brush or pad dipped in ink. Copies are produced by placing sheets of paper under the frame and applying necessary pressure

At best they may be called toy printing presses, and can be utilized to some advantage by those business houses which cannot afford to use any one of the other methods and machines described above

Test Questions

1. What kinds of business documents have to be duplicated, and why?

2. Name the various methods employed in business offices for 'multiplying' copies. Why are they superior to a Printing Press?

3. A firm has to get 100 copies of a notice to be sent to the customers. What duplicating methods would you recommend, and why?

4. What is the difference between?—

(*a*) A Rotary Copier and a Rotary Duplicator.

(*b*) *A Flat Duplicator and a Rotary Duplicator.*

(*c*) A *Rotary Duplicator* and a *Multigraph.*

(*d*) A Hectograph and a Lithograph.

5. What is a 'Multigraph', why is it also known as a type setting process? Describe clearly its use.

6. When is a *Lithograph specially useful; do you know how* to work with it? Describe.

7. Carefully analyse the merits and *defects of each of the Dupli*cating methods you have learnt. Which is the best, and for what reasons?

8. Describe how you will duplicate letters with the Stencil Process.

9. How are copies obtained with the Gelatine Process? Mention the latest improvements effected in this method.

CHAPTER XI

Time and Labour Saving Appliances

The importance and value of time was never better understood than in modern business Efforts are now being made to do the greatest amount of work in the shortest space of time and with least labour And, fortunately enough, mechanical appliances have been and are being invented to aid us in this respect

Besides the Filing apparatus and Copying and Duplicating machines (described previously) a number of mechanical appliances and devices are being more and more made use of in office work, of a business or financial nature They have been designed mainly to speed up work by saving time and labour as much as possible Some of the machines and appliances that have come into common use are described below —

1 **Type Writers**—Everybody, who happens to read this book, is expected to have at least seen a type writing machine These days, nearly every business office, worth its name, must have a type machine Even private persons possess and take advantage of this very useful machine

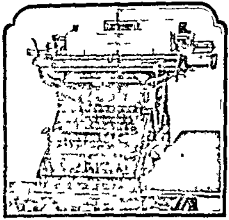
Typed letters are not only very neat and clean but also require less space as compared with hand written letters They have none of the defects of bad hand writing

Most type-writers contain a very useful device, known as the *Decimal Tabulator*, with the help of which long amounts and money columns can be typed easily and correctly (Read this in the Author s Theory and Practice of Type writing, Book I)

2 **Book keeping Machines**—Such Type writers have also been invented and they are being much used in some of the advanced countries, especially in the

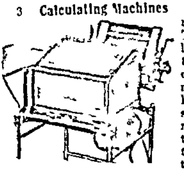
United States of America, by banks, insurance companies and Government Offices

These machines are specially designed to facilitate the work of ledger posting The best known ones are the *Remington* and the *Burroughs*



A BOOK KEEPING MACHINE

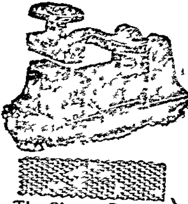
3 **Calculating Machines** They can add, subtract, multiply and divide They are used for typing long columns of figures, the result of which is correctly typed by the machine itself The keys work just in the same way as in an ordinary type-writer, but by the moving of a lever the total or the balance is typed at once The *Comptometer* and the *Dalton* are the most familiar examples and they can perform all arithmetical work



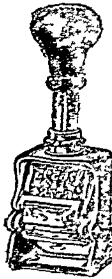
THE COMPTOMETER

4 **Invoicing Machines** are used to prepare invoices and statements in their best forms however elaborate The *Elliot Fisher* is the well known example.

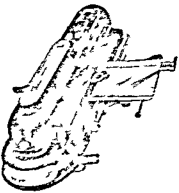
5 **Billing Machines**—They are used to *perforate* the amount both in words and figures on valuable documents, such as, Cheques Bills of Exchange Promissory Notes, etc, in which there is much chance of the amounts in ordinary ink being forged



The Cheque Protector



Numbering Machines.

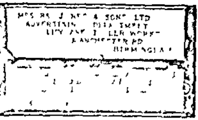


The Cheque Perforator

6 **Numbering Machines**—They can print numbers in consecutive order or only one number many

times over, and are used for numbering invoices, receipts, and other important monetary documents.

7 **An Addressograph**—This machine prints addresses on envelopes. There are several makes of it, the following is the brief description of one of them :—



THE ADDRESSING PLATE
(*Used on an Addressograph*)

Addresses of different customers are engraved on small metal plates, which are placed in the alphabetical order on a tray fixed to the machine. Envelopes are fed into the machine, and on turning a lever, the machine takes up each plate, prints on the envelope, and then places the plate in another tray on the other side Any plate not required can be skipped over A thousand addresses per hour can be printed by working the machine with a tradle

It is very serviceable in those offices where a large number of regular customers have to be addressed frequently.

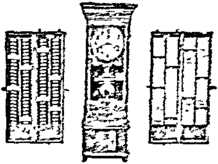
8 **Dictaphones**—In those big businesses where the busy official does not find time to dictate letters *to the correspondence clerk*, during working hours, these machines are used to dictate letters at other odd hours

These machines are built on the principle of gramophones There is a mouth piece attached to a revolving wax cylinder. The letters are spoken into the mouth piece and the cylinder records the impressions of the sounds Afterwards the typist fixes the cylinder on another machine and by regulating

the speed of the sounds either takes down notes or types out directly on the type machine.

Some dictaphones are connected to type-machines. having a special mechanism for the purpose and they type automatically as the dictaphone works.

9. **Time Recorders**—These are clocks of different



OUT *Cards* IN *Cards*
THE TIME RECORDING CLOCK.
(See the In and Out Cards.)

shapes and designs and are made use of in big mills and factories where hundreds of workers are employed on time-wage system, for which exact time of arrival and departure of each worker must be kept.

Each worker gets a card marked with a serial number. When he enters the works he pushes his card into a slot at the base of a big clock put up near the gate. The time is printed on it He places the card in a drawer meant for the purpose, and when he leaves the works, he repeats the same process with his card as before. Their wages are calculated according to the number of hours shown by the individual cards. Those who come late or work shorter hours suffer fines on their wages.

10 **The Cash Register**—*This machine is useful in* Sales Departments, where cash memos are issued to retail buyers by salesmen *This machine* prints the amount on the cash memos, and also keeps a record of each amount on a roll of *paper locked inside it* It also goes on totalling the amounts as they are recorded so that at the end of the day *the manager or proprietor* by looking at the total can ask the salesman to account for so much money received from the customers It not only does away with a Cash Clerk, but also provides useful *record for book keep*ing purposes

THE CASH REGISTER

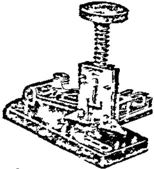
(*See the amount calculated*)

11 **Dating Stamps**—In nearly every office stamps and seals are used for putting down dates and numbers *on letters statements*, accounts etc

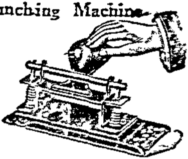
The necessary figures dates and names of months are engraved on revolving chains of rubber By moving these chains the required number date, etc, are brought together The stamp is first pressed on an ink pad and then put on the paper

DATING STAMP

12 **Stapling Tools**—They fasten several papers together very neatly and quickly, by means of small pieces of *stitching wire* *Some makes* use no wire but cut a piece in the tongue like shape from the papers and pass it through a slit cut for the purpose



Staple Machine.



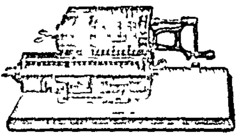
Punching Machine

Punching Machine—It makes two neat round holes in papers for being threaded together, or for insertion in a Flat File

13 **Sealing Machines** are used to put wax seals on letters and parcels very neatfully They save much time and avoid unnecessary waste of wax.

14 **Folding Machines**—In an earlier chapter it has been pointed out that neatly folded letters always display the good taste of the sender of the letters Now, in certain business offices they have to send out at times thousands of letters of the same size, the folding of which would be a long and tedious task Machines have, therefore, been built to do this work, and they can fold letters properly at a speed of about 60 papers per minute They can make different folds *of a paper*, or uniform folds of different sizes of papers

17 ***Ready Reckoners and Tables***—In those offices where most of the work consists of calculation, multiplication, averages, etc., of monetary and other sums, these devices have proved very



beneficial Printed tables are hung up in the office, and they are referred to whenever any calculation is desired to arrive at Tables of multiplication, daily pay or wages and interest tables are most commonly used

CHART SHOWING TOTAL NUMBER OF DAYS FROM ONE DAY OF ANY MONTH TO SAME DAY OF ANY OTHER MONTH

	January	February	March	April	May	June	July	August	September	October	November	December
January	3	334	305	275	245	214	184	153	122	92	61	3
February	31	365	337	306	276	245	215	184	153	123	92	62
March	59	[illegible]	[illegible]	334	304	273	243	212	181	151	120	92
April	90	59	31	365	335	304	274	243	212	182	151	121
May	120	89	61	30	365	334	304	273	242	211	181	151
June	151	122	92	61	31	365	335	304	273	243	212	182
July	181	152	[illegible]	91	61	30	365	334	303	273	242	212
August	[illegible]	181	153	122	92	61	31	365	334	304	273	243
September	243	212	184	153	123	92	62	31	365	335	304	273
October	273	[illegible]	214	183	153	122	92	61	30	365	334	304
November	304	273	245	214	184	153	123	92	61	31	365	335
December	334	303	275	244	214	183	153	122	91	61	30	365

NOTE—In leap year, if the last day of February comes in between, add one day to the number in table

Test Questions

1. Name some 'labour and time saving machines and devices? What need has led to their introduction in business?

2 Describe the nature and use of —

(a) Calculating machines and (b) Book-keeping machines

3 How are addresses written on envelopes in big modern business offices? Describe

4 What is —A Punching Machine, A Stapling Tool, A Sealing Machine, and A Ready Reckoner?

5 Explain how amounts and figures in valuable documents can be prevented against alteration?

6 Describe the nature and use of .—

(a) A Dictaphone, (b) Time Recorders, and (c) A Cash Register

7. Which is the most useful Time and Labour Saving Appliance in your opinion? *Discuss*

CHAPTER XII

Purchase and Sale of Goods

When businessmen have come to know of the various kinds of goods through the different methods described in the last chapter, and *their sources of* supply, they would next settle certain *terms and conditions*, before agreeing to buy or sell actually. In trade it is very necessary, therefore, to have full and clear understanding on the following points relating to goods—(*a*) Nature and quality; (*b*) Prices; (*c*) Packing, (*d*) Time, place, or manner of Delivery; (*e*) Time and mode of Payment.

(1) Kind and Quality—There are a number of things which, though apparently the same, differ in quality. Others which are known by the same name or brand are of varying shapes and sizes to suit particular requirements. Again, goods of the same size or design are sold by different makers and they differ in the material used in them. Some are more durable and costlier, whilst others are cheaper though lighter and less durable. For these and other reasons it is essential to know the exact quality of the thing desired *to be bought, and the following* terms are used to express it:—

Sample or Pattern—A *Sample* is a part or portion of the goods and serves as a specimen of the whole. Raw produce and a good *many food stuffs and other* things are sold by sample, *e.g.*, wheat, sugar, tea, coffee, wines, medicines, inks, etc.

A Pattern is a specimen of manufactured articles, such as cloth, paper, leather, etc. It is meant to show the texture, design, or shade of the article.

When goods are sold by sample or pattern the intending buyer need *not inspect the whole of them* as the seller guarantees that the goods in bulk shall

be of the same quality as the sample or pattern shown Samples and patterns facilitate trade very greatly

Type is a standard sample representing the quality or nature of cereals and food stuffs when they are sold *'to arrive'*, *e g*, Australian wheat, Java sugar, American Cotton The type is taken from the earlier crop and the standing crop is guaranteed equal to it. In most cases when the produce turns out inferior to the type an allowance settled mutually or by arbitration, is made

Description includes the *number*, *trademark*, or *design* of certain goods by which they are generally known and distinguished from others, without showing the 'samples' or 'type'

Things sold by description must conform to description, otherwise the buyer can reject them, even if they are equal to the sample

A Trade Mark is any distinctive mark or device or name put on goods to indicate that they have been produced by a particular maker or manufacturer A number of instances can be cited of familiar trade marks, and most articles now sell by distinctive trade marks, which act as guarantee for the genuineness and quality of those goods

Examples '*Mcon*' pencils '*Swan*' ink, '*Blackbird*' fountain pens, '*Elephant*' kerosene oil, '*Dietz*' Lanterns, etc etc

(2) **Price** is the sum agreed to be paid in exchange for goods, and it is calculated at so much per unit in number weight or measurement In most cases other charges, in addition to the main price, are included in the terms, which are explained below:

Loco Price means *the price of goods as they lie at the place of manufacture or sale* It does not include any charges for packing carriage, etc These

charges have to be paid by the buyer and they are added to the price of goods and shown in the invoice

At Station Price means that the price includes *cartage* to the nearest railway station (or the station mentioned) but not railway freight, which should be paid by the buyer

F O R =(Free on Rail) denotes that the price includes the expenses of carrying the goods to the Railway Station and of loading them into the waggons In other words, it means that the goods will be sent to the Station and loaded into the waggons free of any charge *F. O. R. Destination*, includes also railway freight to the station of destination

F. O B =(Free on Board) means that the price covers all expenses of putting the goods on board a ship Thus it includes the cost of goods, their carriage to port, and the loading charges

F A S (Free along side Ship) means that the seller will pay all charges of sending the goods up to the side of the ship, after which the buyer must arrange for their being put into the ship.

C & F (Cost and Freight) signifies that the price includes the cost of goods, carriage to port, loading and clearing charges, and the freight to the port of destination

C I & F (Cost, Insurance and Freight)—Such a price includes all charges mentioned in the C. & F. price, plus the insurance fee This term is generally pronounced as '*siff*'

Franco, Free, or Randu means that the price covers all possible charges of sending the goods up to the place of the buyer. It is thus made up of the price of goods+cartage+carriage+loading expenses +insurance-fee+freight+unloading and clearing charges+carriage to the godown of the purchaser.

N B—Clearing charges generally mean Customs Duties, [illegible], and Dock dues.

In-Bond Price means that the price does not include the amount of Customs Duty payable. Sometimes goods liable to Customs Duties are stored in the Government Ware-houses at the Docks, and they are allowed to be removed as and when Duty is paid.

Duty-Paid denotes that the Customs Duty has been paid by the seller and so included in the price.

Note.—The last seven terms are used in the Foreign Trade.

(3) **Delivery.**—It is usual for the buyer to mention the particular mode in which goods should be despatched by the seller whether by carts, train or otherwise; and also the place at which and the time during which they are to be supplied. In the absence of any express terms it is supposed that the buyer will take delivery of the goods at the place of the seller and on payment of the price agreed to.

As regards **Mode of Delivery** it is to be noted that when the buyer has mentioned a particular route or carrier, the seller must follow the instructions. In ordinary cases the seller should adopt the usual course and the delivery to the carrier will be taken as delivery to the buyer.

With regard to the time and place of delivery the following terms are in use:—

Prompt Delivery means that goods are to be sent immediately or within a reasonably short time.

Prompt Sale means that the goods are to be sold and their price to be paid on a fixed date, which is called the *prompt day*.

Forward Delivery denotes that goods are to be supplied at some future time; for example, goods ordered in July may be delivered in October.

To arrive means that the goods will be delivered if the ship which is bringing them, arrives safely.

Free overside—This term is used when goods are sold "*to arrive*". It means that the responsibility of

seller ceases as soon as the goods have left the side of the ship, and, therefore, the buyer must himself arrange for a barge or boat to receive the goods and bring them to the docks

Spot Delivery signifies that the goods are ready at the place mentioned and can be delivered at once.

Carriage Paid or **Free Delivery** means that expenses of carrying the goods from the place of the seller to that of the buyer are to be (or have been) paid by the seller

Carriage Forward or Carriage to Pay means that the buyer will have to pay the carriage expenses of the goods

Ex-Ship denotes that the goods are sold free out of the ship, that is the seller is not responsible as soon as the goods leave the side of the ship, and that the buyer must himself arrange to clear them

Ex Quay means that the goods will be delivered after they have landed on the wharf or quay, and the charges for removing them from that place will have to be borne by the buyer

Ex-Godown or **Ex-Warehouse** means that the purchaser should make arrangements for carrying the goods from the godown of the seller.

Shipment or Sailing means that goods are to be shipped on a vessel during the month named, *e g*, "January shipment" means that the vessel carrying the goods must sail any time during January.

NOTE The last four terms are used in Foreign Trade.

(4) Payment- Although payment for goods purchased is made according to the custom or practice prevailing in a particular place or for a particular trade, the following terms indicate the variation in the amount, time, and manner of payment If nothing is agreed then payment should be made at the time of purchase or sale

Net or Nett means that no deduction for discount will be made from the price of goods, at the time of payment.

Prompt cash means payment to be made within *two or three* days after the delivery of the goods, without any discount

Cash, Net Cash, or Ready Cash means payment within *ten* days from receipt of goods, without any deduction

C. W O.=(Cash with order) means that cash is to be sent along with the order for goods.

C. O. D.=(Cash on delivery) denotes that the price of goods is to be paid at the time of delivery.

Spot Cash signifies that payment is to be made just where goods are bought.

5 per cent. Prompt signifies that a discount of 5 per cent will be allowed if payment is made *within a few* days after the delivery of goods.

5 per cent. for Cash means that 5 per cent. discount will be allowed if price of goods is paid within *about a week*.

2 per cent. within a month means discount at 2 per cent. will be given if payment is made *within a month*

2 per cent monthly means that discount at 2 per cent will be allowed, *but account must be settled every month.*

3 months Net signifies that payment may be made within three months, but no discount will be given

Prompt cash, less 2 months denotes that if payment is made within two or three days, interest for 2 months (at the market rate) may be deducted from the price of goods.

Cash against Documents means that the price of the goods is to be paid on delivery of the shipping documents (Export Invoice, Bill of Lading and the Marine Insurance Policy)

Documents against Acceptance (D/A) means that the shipping documents are not to be handed over to the buyer till he has *accepted* the attached Bill of Exchange, drawn by the seller.

Documents against Payment (D/P)—It means that the buyer of the goods must *pay or honour* the accompanying Bill of Exchange before he can get the shipping documents.

Note—The last three terms are used in Foreign Trade

Discount is an allowance or concession made to customers by merchants at a certain rate per cent There are two kinds of commercial discount—

(*a*) *Cash Discount* is one given on the prompt payment of a debt, or payment within a fixed time, or before it is due

Example, suppose you have bought goods worth Rs 500, less 2 per cent in a month. The seller will accept Rs 490, to clear the account any time within a month

(*b*) *Trade Discount* is one allowed on the price of goods, usually by wholesale merchants to retailers It varies, from 2 per cent to 95 per cent according to custom and nature of each particular trade.

As a general practice, it is always shown in the invoice by deducting it from the gross value of goods.

Note—It will thus be seen that if a merchant allows both Trade Discount and Cash Discount the former will be shown in the invoice by deducting it from the price of goods, and the latter will be taken into account at the time of paying this amount

(5) **Packing** means enclosing goods in chests, cases, bales, bags, or other kinds of packages. Small parcels are often wrapped in paper The object of packing is to protect goods from damage while in

course of transit as the carrier is not responsible if goods are damaged due to faulty or insecure packing Therefore, special attention should be devoted to packing goods carefully

Labelling.—An address is generally written on the cover of a parcel Very often however printed *lables showing the name and address of the seller are* used The address of the buyer is written on this label and it is pasted to the cover of a parcel. This act is known as '*labelling* a parcel

Marking—When goods are sent by rail or by sea certain marks and numbers are sometimes put on the parcels, instead of the name and address of the receiver This is called '*marking* a case or parcel. The following are a few specimens —

Weight of goods is expressed in two ways —

(1) *Gross weight*, which is the weight of goods together with that of the case, bag, or box, in which they are packed.

(2) *Net Weight* is the weight of goods only

Tare means the weight of the package within which goods are enclosed, and the term is also used to denote the allowance, deduction or abatement made from the gross weight of the package

Tare is ascertained in five different ways —

Real or Actual Tare is found by actually weighing the package before packing the goods

Average Tare is ascertained by weighing a few packages and then taking the average of the whole

This method is followed when packages are numerous but of uniform size.

Customary Tare—In particular trades when the packages used are always of some uniform weight, then a fixed allowance is made for the weight of the package on the gross weight of goods, *e.g.*, kerosene oil tins, gunny bags for sugar or rice, etc.

Estimated Tare is one which is calculated and agreed to at the time of sale.

Super Tare is an additional allowance made when the packages exceed a certain fixed weight.

Draft or Waste is an allowance on the gross weight of goods over and above the Tare. It is granted by the seller to compensate the buyer for the goods being damp, mixed with dust, leakage in handling, or in respect of some inaccuracies in calculating the Tare.

Tret is an allowance which used to be made formerly on certain articles of trade for damage in transit, or for dust or sand mixed with the goods. (The usual rate was 4 lbs on every 104 lbs.)

Ullage is the allowance for leakage or evaporation made from full measure in bottles or casks containing liquids.

Conditions and Warranties

The buyer of goods is entitled to have any conditions and warranties relating to the goods duly observed and performed by the seller.

A **Condition** is a stipulation, expressed or implied, which is an essential and material part of a contract for the sale of goods. The breach of a condition by one party would entitle the other *to repudiate the contract and reject the goods*. Much depends on the wordings of the terms of a contract whether it is a 'condition' or not. For example, when ordering for say, Typewriting Ribbons, the buyer clearly mentions that they are to be used on Underwood machines, and the seller supplies those usable only on Remington Typewriters, it is a condition broken and the buyer can rightfully refuse to keep the ribbons.

A **Warranty** is again a stipulation relating to the sale of certain goods, but it is collateral or secondary to the main purpose of the con-

tract. The breach of a warranty gives the other party the *right to claim damages* only, but not to reject the goods. For instance, if the Ribbons mentioned above, were warranted as coloured fas, and it turns out on actual use that the colour fades away after some time then the buyer may have them either replaced by better ones or have some reduction allowed in their price.

Thus on breach of a 'condition' by the seller the buyer may repudiate the whole contract or he may claim only damages or he may do both. On breach of a 'warranty', on the other hand, the buyer can only claim the damages.

Implied Conditions and Warranties—According to the principle of *Caveat Emptor* (*let the buyer beware*) the general rule is that the buyer must look to the quality and fitness of goods. In the absence, however, of any expressed stipulation by the buyer and the seller, the law takes regard of the following implied conditions and warranties.—

1 An implied condition that the seller has the right to sell the goods of which he is the owner

2 An implied warranty that the buyer shall have and enjoy full possession of the goods he has bought.

3 An implied warranty that the goods shall be free from any charge of a third party, not declared to the buyer at the time of sale.

4 *Sale by sample*—In the case of a **sale by sample** there is an implied condition —

(*a*) that the bulk shall correspond with the sample in quality, (*b*) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample, (*c*) that the goods shall be free from any defect and they shall be of good merchantable quality (G M Q)

5. *Sale by Description*—In this case there is an implied condition (*a*) that the goods shall correspond with the description, and when sold by description and sample both, they must correspond with the sample as well as the description, (*b*) that if bought by description and without examination they shall be of good merchantable quality, ( ) where the buyer makes known to the seller the particular purpose for which the goods are required and relies on the seller's skill and judgment, they shall be reasonably fit for that purpose.

Rights of the Seller—Besides the primary right of requiring the buyer to accept the goods he has agreed to buy and to pay for them the agreed price, the seller can exercise the following further rights —

1 *Right of Lien*—If the goods are still in possession of the seller he can exercise this right and keep possession of the goods under the following circumstances, till he has received the payment—

(*a*) Where the goods have been sold without any stipulation as to credit,

The measure of damages to which the buyer is entitled is the estimated loss directly and naturally arising from the seller's breach of warranty

Test Questions

1. "In the purchase and sale of goods certain terms are used". What do they generally relate to? Give at least two terms of each class.

2. How is the quality of goods generally known or described? Explain.

3. What is a Trade Mark, what purpose does it serve? Name some *familiar* Trade Marks—Indian or Foreign.

4. What do each of the terms (in pairs) denote —

(*a*) Loco and Station; (*b*) F. O. R. and F. O. B.; (*c*) C. & F. and C. I. & F. (*d*) In Bond and Duty Paid

5. Distinguish between the meaning of each of the pairs of terms —

(*a*) Prompt Delivery, Prompt Sale. (*b*) Forward Delivery, Delivery to arrive, (*c*) Free Overside Free Alongside, (*d*) Spot Delivery, Ex-ship, and (*e*) Ex-quay, Ex Godown.

6. Explain the meanings of the following —Net Cash, Prompt Cash, C. W. O., C. O. D., 1½ per cent. monthly, one month Net; Prompt Cash, less one month.

7. What difference do you draw in the sense of the following words when used in connection with Packing of goods: —

Bag, Bales, Cases, Chests, Crates, Tins, Boxes, Bundles. Give examples of their correct uses.

8. Explain —Tare, Tret, Draft and Ullage.

9. What is Discount? Name and explain its kinds.

10. Explain the sense and use of — E. E., E. & O. E., Free Delivery, Carriage forward.

11. What are "conditions" and "warranties" applicable to the purchase and sale of goods? Give examples.

12. What is meant by *implied* conditions and warranties? Name the chief ones.

13. What difference do you note in the *breach* of a condition and that of a warranty? Explain clearly

14. Classify and explain briefly the *Rights and Remedies* of a Buyer; and of a Seller.

15. Write short notes on —

(*a*) Lien, Stoppage in transit; Re-sale, and Action for Damages.

CHAPTER XIII

Outline of a Trade Transaction

(With Chief Commercial Documents)

Having explained in earlier chapters the general organization of Home Trade and the nature and meaning of various terms and conditions relating to the purchase and sale of goods, we now propose to give the connected outline of a trade transaction illustrated by means of necessary letters and forms of other documents

Origin of a Transaction—As a general rule, when a trader or firm intends to purchase certain goods, a letter is written to one or more merchants or manufacturers asking them to supply the prices of their goods and other terms or conditions of sale Such a letter is called '*Letter of Enquiry*'

This enquiry naturally results in a reply or replies received from the sellers giving their quotations of the goods asked for as regards price, discount, carriage expenses, etc A copy of the Price List is generally enclosed

In modern business, however, it is not a rule that a transaction should originate always with an enquiry, written or oral, from the buyer Manufacturers of goods, large stockists and wholesale Merchants very often try themselves to influence the buyers by issuing their attractive catalogues, or by making special offers and quotations The following are some of these documents explained with their specimens —

A Prices Current is a list of market prices of goods, issued by merchants to their regular customers It shows the *tendency* of prices to rise or fall at the time of its publication Very often daily newspapers contain such lists of prices

It must be noted, however, that a merchant issuing a Prices Current is not bound to sell at those prices since the actual market prices of many an article vary from day to day

(Specimen Extracts from Market Reports)

Calcutta Markets

16th July, 1930

Sugar

The market was steady and prices ruled as follows —

	Rs	a	p
Java White Ready	8	10	0
„ Steamer	8	9	6
„ July—Sept	8	9	0
Java Brown Ready	8	0	0

Gold

	Rs	a	p
English Bar	34	15	0
Mint Bar	35	10	0
National Bank	34	12	0
Leaf Gold	34	8	0

Silver

	Rs	a	p
Silver Bar, Full	46	7	0
„ portions	46	11	0

Hapur Grain Market Report

Hapur, July 1930

Messrs Mukat Lal Madhusudan Dayal have issued the following market report —

	Rs	a	p	
Ready Wheat	3	2	0	per md
Khatti „	3	0	6	„
„ Barley	2	0	6	„
„ Peas	2	7	9	„
Future *Bhadaun* Wheat	3	5	0	„

A Price List is a list or book showing the definite pr ces of goods ready for sale These are the prices at which a merchant is prepared to sell his goods, and they seldom rise or fall in a short time

Specimen Price List

PRICE LIST OF BOOKS
TO BE HAD OF
The Educational Book Co,
Kashmiri Gate Lahore

	Rs	a	p
English Literature			
Arn ld—Selected Essays	2	6	6
Bacon—Essays	1	8	0
Di kens—A Tale of Two Cities	1	8	0
Palgrave—Golden Treasury	1	0	0
Ruskin—Unto the Last	1	12	0
Etc etc		etc	
History and Politics			
Acton—Lectures on History	9	6	0
Davis—Medieval Europe	9	4	0
Fisher Napolean	2	14	0
Gardiner Students History of England (3 Vols)	15	12	0
Lodge—History of Modern Europe	7	4	0
Etc etc	etc		

A Firm Offer and Refusal—A Firm Offer is an offer or proposal made by one merchant to another asking him to buy certain goods *at a given price within a given period* The same goods cannot be sold to any

one else until the proposed buyer has either refused them or the time has expired

A Subject Offer differs from a Firm Offer in that it is made to serveral prospective buyers, (*"subject to the goods being unsold"*) words such as these being written in the offer. This means that the earliest buyer will have the chance of being supplied with the goods.

Specimen Offer

> 21, Sadar Bazar,
> *Delhi, 12th June, 1935*
>
> Messrs Harnam Das & Sons,
> General Merchants,
> Amritsar
>
> Dear Sirs,
>
> Referring to our quotations of the 8th inst., we now beg to offer your firm, subject to our receiving your reply before 12 noon, the 16th of June, 2 doz each of American and German Lanterns at Rs 14 and Rs 12 8 0 respectively.
>
> We believe you will avail of this opportunity.
>
> Yours faithfully,
> *The Union Trading Co*

A Tender or Estimate is a written offer to supply a given quantity of certain goods, or to perform a certain work at given prices and terms. The document containing the prices, terms and other conditions of the work to be done is called the *Specifications*.

It is mostly Govt Departments, Railways, Municipalities, and other public institutions that invite through newspapers or circular letters, people to give their tenders, e.g., for the construction of roads, bridges, etc. Until a tender is accepted there is no binding contract.

Specimens of a Tender

(1)

EAST INDIAN RAILWAY
NOTICE

The undersigned will receive sealed Tenders on authorised forms (price Re 1 per copy) at his office upto 12 hours on 2nd September, 1930, for the supply of copper and steel plates

2 The right to reject a tender without assigning any reason is reserved

3 For further particulars apply to —

(Sd) *F E Anderson*,
Controller of Stores
E I Rly Headquarters Office,

Calcutta, dated 26th July, 1930

(2)

TENDER NOTICE

Sealed Tenders are invited for the construction of the Sumera Power House at mile 163 of the Ganges Canal in the Aligarh District

2 *Tenders should reach the office of the* Executive Engineer, Meerut, on or before 2 P M on 1st August, 1930, when they will be publicly *opened*

3 The successful tenderer will be required to sign an agreement for the work within 4 *days and deposit a sum of Rs 1,000 as security* money for the contract

4 Plans of work can be seen at the office of the Executive Engineer, and copies of tender forms and conditions of contract obtained there from on payment at Re 1,

(Sd) *P C Agarwal, I S E*,
Executive Engineer,
Meerut

An Enquiry—This is a letter which a trader intending to buy goods writes to other merchants and manufacturers He requests them to give their quotations for the required quality and quantity of goods

Letter of Enquiry

Temple Road,
Amritsar, 5th June, 1925.

The Union Trading Co.,
21, Sadar Bazar,
Delhi.

Gentlemen,

We shall be pleased to have your lowest quotations for the following kinds of Lanterns :—

Hurricane, "*Dietz*" }
Hurricane, "*Feurhand*" } medium size
Hurricane, "*Sunshine*" }
Little, *Wizard*, American
The '*Feurhand*', German

We are wholesale dealers in the market for Lanterns and Lamps and should your prices suit us, a heavy order is most surely to be placed for *the above brands. Please let us hear at the earliest.*

Yours faithfully,
Harnam Das & Sons.

A **Quotation** is a statement of prices and terms given by a merchant *in reply to an enquiry made by a customer*, who intends to purchase goods. Thus a quotation generally takes the form of special rates and terms

Reply to Enquiry

THE UNION TRADING Co.,

12, Sadar Bazar,

Delhi, 8th June, 1935

Messrs Harnam Das and Sons,

General Merchants,

Amritsar

Dear Sirs,

In reply to your enquiry of the 6th inst we have the pleasure to quote you as under —

Hurricane, "Dietz"	Rs. 15	per doz
Hurricane, "Feurhand"	12/8	,,
Hurricane, "Sunshine"	10/8	,,
Little Wizard, American	18/-	,,
Little Wizard, German	16/8	,,

We are prepared to allow you 2½ per cent discount for cash, and free delivery on all orders of Rs 200 or more

Awaiting your esteemed commands,

We are, Dear Sirs,

Yours faithfully,

The Union Trading Co.

The Order.—On receipt of quotations from different sellers, the buyer, naturally compares one with the other and decides to place an order with the firm whose prices and terms are supposed to be the best in all respects

The letter of *Order* contains *full particulars* as to the quantity or number of articles or goods desired *to be purchased, their quality, the rate of each, method* of packing, time and place of delivery and payment, together with other necessary terms Mostly a

printed *Order Form* is filled up and enclosed with a letter, or it may be sent by itself

To make a contract legally binding oral orders and bargains are confirmed in writing

There are different ways of recording orders received, but the most convenient is the use of an **Order Book** which has columns for—(1) Date received, (2) Name and Address of the buyer, (3) *Description of Goods* (4) Price (5) Date when goods are to be supplied and (6) *Sales Book Folio*

Letter of Order

No 93/A Temple, Road
Amritsar, 10th June, 1935

The Union Trading Co
21 Sadar Bazar,
Delhi

Dear Sirs,

With reference to the quotations as per your letter of the 8th inst, we are glad to *order for* the following —

Hurricane medium size

4 Doz of each brand

6 Doz of 'Little Wizard" (American)

2 Doz of 'Little Wizard (German)

Please pay particular attention to packing and forward them carriage paid to City Station

Payment will be made within one clear week from delivery of goods as agreed

Yours faithfully,
Harnam Das & Sons

Or

Order Form

Harnam Das & Sons

General Merchants.

—— : o :——

Order No. 93/A

Amritsar, 10th June, 1935.

To

The Union Trading Co.,
21, Sadar Bazar,
Delhi.

Please supply the under-noted Lanterns at your earliest convenience :—

Number or quantity	Description.	Rate
		Rs. a
4 Doz	Hurricane "Dietz" ...	15 0 per doz.
"	" "Feurhand"	12 8 "
"	" "Shunshine" .	10 8 "
6 Doz.	*Little "Wizard" (American)* ...	15 0 "
2 Doz	Little "Wizard (German)	15 8 "
	Instructions —Per Goods Train, Carriage paid	

Harnam Das & Sons.

Need for Credit and References —Credit is the foundation of modern business. It means that the buyer should be allowed sufficient time to sell off the goods and to collect money from his customers before he may be asked to make payment for the goods purchased.

Sheet, though this is not always very helpful in disclosing the information desired

When *reference is being taken up it is usually* asked whether it would be safe and advisable to extend credit to the buyer in question upto *a certain amount*, and whether he is honest in his dealings and regular in payments All information so supplied is *kept strictly confidential* and without any kind of obligation on the part of the party supplying it

The following letters will illustrate the above points —

Asking for Trade References

THE UNION TRADING CO,

21, Sadar Bazar

Delhi 12th June, 1935

Messrs Harnam Das and Sons,

General Merchants,

AMRITSAR

Gentlemen,

We thank you for your valued order No 93 A of the 10th inst, and the same is receiving our careful attention

This being, however, the first chance of our entering into business relations with you, we believe you would excuse us if we ask you to supply us at least two names as references

Awaiting to hear at your earliest,

We remain, Gentlemen,

Yours faithfully,

The Union Trading Co

Furnishing Trade References

Temple Road,
Amritsar, 15th June, 1935

The Union Trading Co,
Sadar Bazar, Delhi.

Dear Sirs,

Replying to your letter dated 12th June, 1935, we have to say that we presumed our name was already on your list We are glad, however, to refer you to —

1. Messrs Muhammad Beg Islam Beg
   11, Market St., Amritsar
2. The Punjab Bank Ltd, Upper Road, Amritsar

We require the goods very urgently and would, therefore request you to pay early attention to the matter.

Faithfully yours,
Harnam Das & Sons

Requesting Information

21, Sadar Bazar,
Delhi, 18th June, 1935

Messrs Muhammad Beg Islam Beg,
11, Market St, Amritsar.

Dear Sirs,

We shall deem it a favour if you, please supply us *Confidential information* with regard to the financial position and business dealings of Messrs Harnam Das and Sons of your city.

They are desirous of beginning credit relations with us and have given your name in reference

Assuring you of our promptness to reciprocate on similar occasions, and enclosing a stamped and addressed envelope,

We are, Dear Sirs,
Yours faithfully,
The Union Trading Co.

Reply to above—Unfavourable

11, Market Road,
Amritsar, 22nd June, 1935.

The Union Trading Co.,
21st, Sadar Bazar,
Delhi

Dear Sirs,

With reference to your letter of 18th inst. we are surprised to note that Messrs Harnam Das and Sons should have mentioned our name as reference We have no hesitation in saying that we have experienced much difficulty in settling our accounts with them, and for the last six months or so we have stopped all credit business with them

The firm, no doubt, is of long standing and possesses ample funds, but they are extremely careless in their business dealings

We supply this information in strict confidence and without obligation

Yours faithfully,

Muhammad Beg Islam Beg.

Request for Cash Payment

THE UNION TRADING Co.,
23, Sardar Bazar
Delhi, 25th June, 1935

Messrs Harnam Das & Sons,
Temple Road,
Amritsar

Dear Sirs,
As you are in urgent need of the goods we shall be glad to forward them to your address provided you are willing to pay for them on delivery

We write this after careful consideration of the whole matter, and hope would not be regarded as rather exacting in our business practice

Assuring you of our best attention at all times,

We are, Dear Sirs,
Faithfully yours,
The Union Trading Co

Despatching of Goods—If the information regarding the buyer's business status and financial position is favourable, the seller will soon arrange to execute the order On the contrary, should the reply received from the person or party referred to turn out to be unsatisfactory, the buyer will be asked in a courteous manner to send cash in advance, whole or in part. In most cases, however, the reference taken up is quite satisfactory, and the seller at once writes to the buyer saying that goods are being despatched within a specified time.

Packing—The order is signed and approved by some responsible person and then passed on to the warehouse-man, who collects in one place all the articles mentioned in the order. They are also carefully examined or tested. Next, the goods are packed suitably and strongly by expert packers, again comparing them with the order. When chests, cases, or

boxes, etc, are used they are made to size so that goods inside after having been enclosed may not be loose or too light, because they are liable to be broken or damaged in both cases

Finally, the packages are properly labelled and addressed, and stocked in a heap ready for despatch On the outside of the packages containing fragile or delicate things such as glassware, bottles of medicine, etc, certain words of caution are printed in bold letters on the labels so that they may be properly and carefully handled by porters or coolies while loading and unloading The words used generally are— "GLASS WITH CARE," "THIS SIDE UP," according to the nature of goods

Then the packages are carted to the Railway Station if they are to be sent by rail, and the R/R is obtained for them which has to be forwarded to the buyer along with a copy of the *Invoice*, both enclosed in a letter of advice, as shown below :—

Advice of Goods sent

THE UNION TRADING Co
23, Sadar Bazar,
Delhi, 30th June, 1935

Messrs Harnam Das & Sons,
Temple Road, Amritsar

Dear Sirs,

We are glad to advise you that we are forwarding to day per passenger train, carriage paid, the goods as ordered in your letter No 93/A of 10th instant

The *Railway Receipt* we have sent through V P P for Rs 298 8-0, the amount of the Invoice herein enclosed

We are sure the goods will give you complete satisfaction

Yours faithfully,
The Union Trading Co

Encl 1

On the other hand if it has been so agreed that the buyer will pay for the goods in cash or accept a Bill of Exchange (or even pay it) the R/R will not be *enclosed with the Invoice but sent separately by* V P post or through some bank

NOTE—The subject of carriage of goods by rail and other methods has been discussed in a previous chapter and the student may refer to it once again.

— o —

Carriage of Goods

It has already been pointed out that *Transport and Insurance* are very important auxiliaries or aids to trade proper There are three main branches of transport—land, water and air—and each is highly developed and perfected these days because of Railways, Steamships and Aeroplanes

Since transport or carriage of goods from one place to another involves certain *risks and damages* to goods the practice of insuring against these risks has also grown increasingly important *Insurance* is a sort of contract by which the insurer undertakes to indemnify the insured against loss arising from fire or marine risks, in lieu of a small premium paid by the person insured

The subject of Transport and Insurance is vast and the student will meet with its discussion in some details later on Here it is proposed to explain how land carriage of goods is usually effected in the Inland Trade

Goods are despatched by one or other of the following ways —

1 **By Coolies** or **Porters**—Small parcels of goods, are frequently delivered by coolies or porters who carry the goods either on their person or if the weight is sufficient, make use of hand carts or *'thelas'* When goods are delivered though messengers or

coolies, the signature of the buyer is taken in a book called the Delivery Book especially ruled for the purpose

2 **By Post**—It has already been explained how most parcels of light weight and high value are sent through the agency of the Post Office

3 **By Common Carriers**—A common carrier is one who carries goods as his regular business, and who holds himself out as ready and willing to do so for any person wishing to engage him Regularly plying carts lorries, and the railways are instances of common carriers The consignor may hire the vehicles of the carrier and load these as he pleases, or he may deliver the packages to the carrier and leave the rest to him

A common carrier is a mercantile agent in the usual sense of the term since he is entrusted with the possession and care of goods as well as their delivery to the desired person or place (See *chapter on Agents*)

Carriage by Rail

Although carriage of goods by motor lorries is increasing day by day the railway still retains its premier position in the sphere of land transport particularly *for heavier goods* We shall now explain how goods are forwarded both by a Goods Train and a Passenger Train

A Consignment Note is a document used when goods are sent by *Goods or Luggage Trains* It *contains the name* and address of both the consignee and the consignor, and other particulars as to number, description weight of goods, etc

It is a contract between the sender or consignor of goods and the railway company It contains full particulars of the terms and conditions upon which the railway company undertakes to carry good

Risks—Goods may be sent either at the owner's risk (O R) or at the Company s Risk (C R), in which case the railway company is responsible for any loss or damage caused to goods while in transit Railway companies carry at their own risks all goods which are not supposed to be easily perishable or dangerous, by charging ordinary rates of freight

Fragile Goods and those of a perishable nature, such as, Fruits Sweets, Fish, Milk, etc, are usually carried by railway companies only at the risk of the owner or sender

Although the rates charged in the case of O R Notes are naturally much lower, but the company accepts no liability for loss or damage, except for wilful misconduct of the servants, which is rather difficult to prove

When the goods are desired to be forwarded at Owner s Risk the sender has to fill up and sign an Owner's Risk Note before they would be accepted for transit

A Forwarding Note—When goods are sent by a *Passenger Train* the consignor has to fill in a *Forwarding Note*, and not the consignment note If the goods are damageable a Risk Note whether O R or C R, will also be necessary

Freight is the charge made by Railway or Shipping Companies for the service of carrying the goods from one place to another

Goods are divided into different classes according to their nature and the risk involved in transporting them The rates of freight also vary accordingly Freight is calculated either on **weight** or on **measurement** according to the nature or quality of goods

The rates of freight charged for goods sent by Passenger Trains are, of course much higher than for those sent by Goods Trains, simply because the goods reach their destination so soon, and without much danger of being damaged or spoiled if they are perishable

Specimen Consignment Note.

Station, Agra Cant
19th June, 1930

The E I Rly Company are requested to receive and forward as per address and particulars on this Note, the undermentioned goods, on the conditions stated on the other side

Sender's address and signature } Ram Chand and Sons, Rawatpara Agra

Wagon No	Consignee Name	Consignee Address	To what Station	No of Cases etc	Description of goods and marks	Weight	Charges paid	Who pays
						Md sr	Rs a p	
	Behari Lal Lam kand	Aligarh	Aligarh	1	Brushes	12	7 0	the sender

A Railway Receipt (R R) is a receipt given by a Railway Company to the consignor of goods It contains the following particulars —

1 Names of the consignor and consignee,

2 Place of destination of goods,

3 Description and quantity of goods,

4 Amount of Freight (paid or to be paid)

On the back of a R R are printed the conditions on which the Railway Company undertakes to carry the goods

The consignor sends the R/R to the consignee by post, so as to enable him to take delivery of goods from the railway station. It will have to be *endorsed* by the consignee before he will be given possession of the goods

When the goods are consigned "to self" (that is the consignor s name is also mentioned in the place meant for the consignee) the consignor of goods should not forget to endorse it in favour of the consignee before it is despatched. The consignee will have to endorse it again when delivery of goods is being taken from the railway company and also to give a *receipt for the goods*

The Indemnity Bond—In case the R/R is lost by the consignee, he will have to execute a bond and stamp it before goods can be taken delivery of If the consignee is not quite known to the railway authorities, he will also be required first to get the written consent of the consignor through the forwarding station

Demurrage—If the goods are not removed from the railway station, to which they have been sent, within a fixed time (usually 2 days), the consignee has to pay a penalty, commonly known as "demurrage"

Specimen Railway Receipt

Receipt No.

EAST INDIAN RAILWAY

Risk Note Form No. Received the undermentioned articles for despatch No 073877.

Sender Consignee

From To Date 194 Credit Note No ..

Description	Number	Weight			Freight		To be filled in by Receiving Station		
		Md	Srs.	Ch	Rs	As	U/C	O/C	
									FREIGHT TO PAY UPON DELIVERY
Total									Parcel Clerk

When Parcels are charged by measurement the actual measurements must be shown in the description column.

NOTE.—It must be distinctly understood that the Railway Administration claim the right to correct any charges ... that may be undercharged in this Receipt and that they reserve to themselves the right of re-measurement re-weighment and re-calculation at the place of destination. Special attention is drawn to the notice on the back, which forms a legal contract

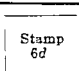
A Bill of Lading is a document given by a Shipping Company to the shipper of goods, containing the terms and conditions on which the ship-owners contract to carry the goods.

It is an acknowledgment by the shipping Company that goods have been received on board "in good condition and order" and that they will be delivered at the port of destination in the same good condition.

Full particulars of the goods are entered in a B/L—number of cases, bales, marks, port from and to shipped, names of consignor and consignee, etc.

Specimen Bill of Lading

Stamp
6*d*



Madras
4 cases.
101/104
Charges
£1—5—0.

Shipped, in good order and condition by B. Merchant & Co., in and upon the good steamship "Commonwealth" whereof William Brown is Master for this present voyage, and now lying in the port of London and bound for Madras (India), 4 cases of Electric Lamps being marked and numbered as in the margin, and to be delivered from the ship's deck (where the shipowner's responsibility shall cease) in the like good order and condition at the aforesaid Port of Madras, India, (the Act of God, the King's Enemies, Fire, Boilers, Steam, Machinery, and the consequence of defect therein or damage thereto, and all and every other dangers and Accidents of the Seas, Rivers, and Steam Navigation of whatever nature or kind excepted) unto Order of the Electric Trading Co., or their Assigns, they paying Freight for the said goods as per margin, with charges, primage, and average accustomed. In witness whereof Master or Agent of the said ship has affirmed to three Bills of Lading, all of this Tenor and Date, the one of which three Bills being accomplished, the other two to stand void.

Dated in London, 22nd August, 1939.

William Brown

A Marine Insurance Policy—Goods sent on ships are always in danger of marine and other risks for which the shipowners do not hold themselves responsible. The goods are, therefore, insured with Insurance Companies which undertake to indemnify the owner of goods in case they are lost or damaged. The document containing the terms and conditions of such a contract is known as a Marine Insurance Policy.

A Dock or Warehouse Warrant (D/W, W/W) is a receipt for goods placed on Docks or in a Government Warehouse. It contains such particulars as are necessary to identify the goods —(1) Name of the ship which brought the goods (2) Marks on cases, (3) Weight, (4) The Date *from* which rent commences, etc.

Specimen Dock Warrant

The Bombay Docks Corporation

No 139 21st July, 1936

Warrant for *100 Bags Sugar* Per S S '*Ganges*', Master S *Patterson* from *Cape Town*. Entered by *Messrs Samul Dass & Sons* on the *20th July, 1936*. Rent commencing from *this date*.

Marks	Numbers	Weight			
		Gross		Tare	
		Mds	Sr	Mds	Sr
S D S	1/100	250	30	1	4
		1	4		
Bombay		249	26 Net		

Examined and entered—by *G Warrant Clerk*

Deliver the above goods to Messrs. Samal Das & Sons or assigns as per endorsement hereon.

P [illegible]
Warrant Clerk

A Delivery Order (D/O) is an order issued by the person whose goods lie at a Dock or Warehouse, asking the *Superintendent* (of the *Dock or Warehouse*, to deliver the goods to the bearer, or to the person named therein or to his order. When it is 'to order' it requires endorsement before goods would be delivered. Printed forms are generally used for D/O's

Delivery Order

No :8

KALBADEVI ROAD,
Bombay, 10th Aug., 1936.

To

The Superintendent,
VICTORIA DOCKS

Please deliver to *L. Hira Mal Bhagwan Das* or order, the undermentioned goods entered by *L Samal Das and Sons*, on 20th July, 1936, ex ship "*Ganges.*"

Captain : *S Patterson*, from *Cape Town.*
Charges : Rs. 13-10-6

Marks	No	Particulars
S D S Bombay	1/50	Bags of Raw Sugar.

(Sd.) SAMAL DAS & SONS.

Test Questions

1 What is a Prices Current, a Price List, and a Quotation? How does each differ from the other?

2 Explain clearly —

A Firm Offer, a Subject offer, a Tender or Estimate

3 What is a Trade Reference, and how is the financial position and business status of a customer usually known?

4 Assume an imaginary case in question No 3, and write out the *necessary letters supposing the reply to be unfavourable.*

5 Write a short note on the Packing and despatching of goods.

6 Explain how goods are forwarded by Rail, both Passenger and Goods Trains.

7 Describe the nature and use of a Railway Receipt

8 Write short notes on —O R and C R, Demurrage; Bill of Lading, and Indemnity Bond

9 What is (*a*) a *Dock Warrant*, and (*b*) a *Delivery Order*; *what is* the difference between them?

CHAPTER XIII—*(Contd)*

Invoices, Statements, etc

An Invoice is a statement, sent by the seller of goods to the buyer, showing in full the names or description of articles, their number or amount, rate at which each is sold, discount if any, and the total amount together with charges for packing, carriage, etc

Its importance:—An invoice is a very important document of business transactions Its usefulness can be judged from the following—

(1) It is a notice to the buyer that goods have been despatched, and if they do not reach in time enquiry may be made

(2) Goods can be compared with the description in the invoice and any mistake as to quality, amount, rates, etc, can be ascertained

(3) The buyer can arrange for the re-sale of goods before they have been actually received, since the invoice generally reaches earlier

(4) If terms are '*Cash Payment*,' or '*Cash against Documents*,' the buyer can make arrangement for necessary money in due time

(5) He can keep his Books of Account properly, as the charges for carriage and other expenses, amount of Discount or Commission, etc., can be correctly known

(6) It is a proof of the sale of goods, and clearly shows who is the debtor and who is the creditor

(7) When goods are exported or imported the '*Customs Duties*' are calculated on the basis of the invoice

Kinds—Invoices are *Ordinary* and '*Pro Forma*' Again, they may be *Inland or Foreign* according as

the goods are sold in the same country or in another country

A 'Pro Forma' Invoice.—The words 'Pro Forma' mean '*for the sale of form*', and, hence, such an invoice is not a real invoice, but one that is made out for showing its probable form.

However, there is no difference in the preparation and writing of an ordinary invoice and a Pro Forma invoice, except that the latter is marked with the words '*Pro Forma*,' at the heading.

A Pro Forma Invoice is used on the following occasions :—

(1) When goods are *forwarded to an agent to be sold on behalf of the principal a Pro Forma Invoice* is sent to him, so that he may know the actual cost of goods along with other expenses, and thus try to sell them at a profitable price

(2) Sometimes, merchants before actually buying certain goods like to know their prices, charges of pack*ing and carriage, the discount allowed, terms of payment*, etc , so as to find approximate total cost of the goods In such a case they send the order asking the seller to forward a Pro Forma invoice before despatching the goods themselves.

(3) When a merchant receives a very small order, or when the customer is a stranger and it is not desired to open a credit account with him, the goods are not supplied *but a Pro Forma invoice is sent to him*, thus indirectly asking the buyer to remit beforehand the price of the goods

(4) When goods are liable for Customs Duties, a *Pro Forma Invoice has to be shown to* the customs authorities so that the duty may be ascertained and paid accordingly.

Note —Before an Invoice is posted to the buyer it should be very carefully checked by the person other than the one who prepared it, and a copy of it should also be kept

The Invoice should not be enclosed in the parcel of the Goods, but it should be sent by post along with Advice Note

An Advice Note is a letter advising the buyer of the despatch of goods. The Invoice and the Railway Receipt, if any, are enclosed with this letter.

On receipt of an invoice the buyer should compare it with the copy of his order, check the calculations and the total, and then initial it.

After the goods have been received and checked, *the invoice should be carefully preserved. There are* several ways of doing this, but the general practice is to keep it in a '*Guard Book*.'

The Guard Book— This is a large Scrap Book usually made of cartridge paper. On the right hand side of each page are ruled money columns. The invoices are folded, endorsed, and pasted into this book, and the total amount of each is shown in the money columns

Specimen Guard Book

	Rs.	a.	p.
16th March, 1935 Gaya Prasad and Sons.	232	10	6
21st April, 1935 Bhika Mal Gulzari Lal.	545	4	9

How to prepare an Inland Invoice

Invoices are generally set out on special forms with beautifully printed or engraved headings, showing the name of the firm, nature of business carried on, and the address

The Telephone No, the telegraphic address, the name and edition of code used, and sometimes the terms of trade, are also printed at the heading

Besides the heading, an invoice should contain the following :—

1 Date on which it is sent This is written at the right top corner.

2 Name and address of the buyer, written at the left

3 If the name of seller is not shown in the heading, it should be written in the centre preceded by the words 'BOUGHT OF'

4 Terms with regard to mode of transit, carriage paid or forward, rate of cash discount, time of credit, etc, are generally written above the details of the goods —

5 The details of goods form the body of the invoice and show :—

(a) Number or quantity of goods,

(b) Names or description of articles,

(c) Price or rate of each class of articles,

(d) Amount of price of each class of articles,

(e) Discount, charges for packing, carriage, etc, if any

All these particulars are written in upright columns running one after the other The amount column is totalled and ruled off

6 The signature of the seller appears at the right bottom corner

7 The abbreviation "E & O E", meaning "*Errors and Omissions Excepted*" are often put down at the end of an invoice They entitle the seller to correct any mistake or omission that might be discovered in the invoice

The K. V. Boot & Shoe Manufacturing Co ,
(Manufacturers & Importers
of High Class Footwear)

—o—

Lucknow, 10th June, 1930

Teleg, Add—"Leather
Tele No—187
Code—A B C (6th Edn)

To

Messrs Abdul Majid Khan & Sons,
Boot and Shoe Merchants,
Aligarh

No	Size	Description.	Rate	Rs.	a	p.
			Rs			
6 prs	8/4	Men s Tan Boots ..	5/	30	0	0
10 ,,	7/4	Men s Canvas Shoes ..	3/8	35	0	0
4 ,,	9/4	Gent. Glace Derby	6/8	26	0	0
15 ,,	33	Ladies' Slippers	2/12	41	4	0
8 ,,	33	Ladies' Full Slippers	3/4	26	0	0
				158	4	0
		Less Trade Dis. @ 10 %		15	13	0
		E & O E.		142	7	0

For the K V Boot & Shoe Mfg Co
B N Verma

Per E I R Goods Train,
Carriage forward

Telegraphic Sialkot, 27th May, 1935

Address—"Sports".

To

Messrs Raghubir Narain & Bros ,

General Merchants, Khurja.

BOUGHT OF—UBEROI SONS & CO.,

Manufacturers of High Class Sports Material

Terms—Net Cash Packing Free.

		Rs	Rs	a	p	Rs.	a	p.
2 Doz	Hockey Sticks—							
	1 doz Rubber handled	30/	30	0	0			
	½ doz Stripped handled	24/	12	0	0			
	½ doz Leather Bands	26/8	13	4	0			
			55	4	0			
	Less Discount @ 5%		2	12	2	52	7	10
1 set	Ping Pong Articles	18/10				18	10	0
½ doz	Volley Balls—'Perfect'	27/	13	8	0			
	Less Discount @ 2½%		0	5	5	13	2	7
	Add—Carriage					1	6	6
	E & O E	Total				85	10	11

Uberoi Sons & Co

Foreign Orders and Invoices

An Indent is an order for goods sent to (or received from) a foreign merchant

It contains full particulars regarding the quantity and quality of goods, their rates, manner of packing and marking and time and place of delivery, etc

A Foreign or Export Invoice is one which is prepared in connection with goods sold to a foreign merchant It differs from an Inland Invoice in some respects—

1 The heading usually contains —

(a) A short description of the goods

(b) Name of the ship on which they are shipped.

(c) From and to which ports

(d) Name and address of the purchaser

2 In the first column are given the marks, signs and numbers put on the packages These are meant for indentifying the goods, when the importer claims them at the docks

3 They are prepared in different ways, in accordance with the terms, *Loco*, *F O B.*, *C. I F*, etc

4 An Export Invoice is generally prepared in *three or four copies*

The examples following should be carefully studied —

Indent

The Electric Trading Co

Telegrams : "ELECTRO"
Madras
Code used "Bentley's"

Madras, 14th July, 1935

Messrs B J Merchant & Co ,
London

Dear Sirs,

Please purchase for our account--

Goods : Electric Pocket and Cycle Lamps

Quantity or Number : 2 Doz each

Prices Pocket Lamps @ 10/6 per doz

Cycle ,, @ 24/- ,,

Packing and marking

E T C

Madras.

Delivery To be shipped by P and O Liners

Freight and Charges Charged forward on Invoice

Insurance To be effected in London for 15% over invoice value

Invoice One copy each of invoice consular invoice and certificate of origin to be forwarded to us by mail

Payment —D/A Draft for 60 days

Instructions Pay particular attention to packing of bulbs shipment as early as possible

Yours faithfully,
R S Iynger,
Manager

Export Invoice

Invoice of 5 cases cotton Goods shipped per S S "Victoria" for account and risk of Messrs. Bruce & Sykes Calcutta

Indent No 152. Insurance effected here

Marks	Particulars		£	s	d	£	s	d
B C S	Gray Dhoties, ½ in. coloured border							
	1C/ 400 pcs., 42 in							
	4C/ 800 pcs., 44 in.							
	1200 @ 3/	–	180					
	Less 2½%	—	4	10				
						175	10	
						175	10	

Liverpool

24th July, 1935 *Merchant & Co*

Correction of Mistakes—Mistakes sometimes occur in invoices, they are corrected as follows :—

(1) When a mistake is discovered within a day or two of sending the invoice, it may be cancelled by forwarding a correct one

But one great drawback of this method is that the accounts in the books have to be altered, which a businessman would not like

(2) Therefore, the most usual practice is to use *Debit* and *Credit Notes* for correcting invoices.

Note.—A Debit is a charge or sum payable by a person, who is called the *Debtor A Credit* is a charge or sum payable to a person, known as the *Creditor*

A Debit Note (D/N) is a statement showing the particulars of the amount debited against a person. It is sent by the seller of goods to the buyer whenever by mistake goods are (a) *undercharged*, (b) or the invoice is *undercast*, (c) or when some item is not included in the invoice

Note—*To undercharge* means to calculate the price of goods at a lower rate than it ought to be

To undercast means to total the invoice less, by mistake

Debit Note

Lalimli Buildings,
Cawnpore 20th June, 1935.

Messrs John Brown & Sons
Cant, Agra

Dr to **The Cawnpore Woollen Mills Ltd**

		Rs	a	p
Invoice 8th June	To undercharging of Blankets, Plain, $2\frac{1}{2} \times 1\frac{1}{4}$ at /4/ each	2	8	0

C B Lal

A Credit Note (C/N) is a statement (printed usually in red) showing the particulars of the amount credited to a person

It is sent by the seller to the buyer—

(a) When goods are returned on account of some defect

(b) When empty cases or packages (which have been charged for in the invoice) are returned in good condition to the seller

(c) When an allowance is made to the buyer for short-weight, damage, or some defect in goods

(d) When the goods are *overcharged*, or the invoice is *overcast*

Note—When goods are damaged, or they are short in quantity or number, *it is the buyer who points out the defect by sending a Letter of Complaint* The seller then forwards a C/N

Credit Note

	Lucknow, 20th June, 1935 Messrs. Abdul Majid Khan & Sons, Aligarh. *Cr* by The K. K. Boot and Shoe Manufacturing Co			
Invoice		Rs	a.	p.
10th June	By Return of 2 prs. Ladies' Full Slippers (damaged) at Rs. 3-4-0.	6	8	0
„	By overcharge of 4 prs. of Gents' Glace Derby at / 4/ ...	1	0	0
		7	8	0
	D. N. Tandon, *Manager*			

A Statement of Account (S/A) is a document which is sent by a merchant to his customer, monthly, quarterly, or at the end of some other period. It sets forth the value of goods bought at different dates by the customer, as well as the amounts of cash received from him and discounts or reductions allowed to him, thus showing the balance due at the date of the Statement.

Whenever there is a balance coming over from the past period it is put down first of all in the statement.

Note.—'To render an account' means to send a statement of Account

It serves two purposes :—

1. It is a reminder to the customer to pay up his account at the due date

2. Accounts as kept by both the parties can be compared, and mistakes if any can be corrected, thus avoiding further delay.

Statement of Account

Sadar Bazar,
Delhi, 17th June, 1930

L. Pirbhu Dayal,
General Merchant,
Khurja

In a/c with Md Yakub Md Idris

1930			Rs	a	p	Rs	a	p
June,	15	To *Balance b/f*				50		
,,	18	To Goods	146	10	6			
,,	29	To Goods	210	4	9			
July,	13	To Goods	190	14		547	13	3
						597	13	3
June,	25	By Cash	150					
July,	6	By Cash	250					
,,	15	By return	10	8		410	8	
		Balance due				187	5	3

Muhammad Yakub Muhammad Idris

Methods of Payment—*There are different methods of remitting money or making payments for the price of goods, as shown in the diagram given below.*

Methods of Payment

(For Inland Remittance)

- In Cash
  - *Coins of Gold and Silver*
  - Currency Notes, or Bank Notes
  - Money Orders or V.P Post
  - Stamps and Postal Orders (for very small sums)
- By credit Instruments
  - Cheques
  - *Bills of Exchange* or Hundis
  - *Promissory* Notes and Bank Drafts

When the terms regarding payment agreed between the buyer and the seller are 'prompt cash' or 'cash on delivery', we have learnt that the usual method is to make the payment through the post, the R/R being sent by the seller as a V. P. P. If the R/R is sent through a bank then payment is made through the bank.

When some credit is allowed to the buyer and the Statement of Account is received from the seller it is checked carefully with the buyer's own books of account and payment is then made either by cheque or by a Bill of Exchange or a Hundi.

In case the amount to be remitted is small, payment may be made by a Money Order (or a Postal Order) or by sending Currency Notes under insured cover. But in business these methods are seldom used because of their expensiveness, and also because

businessmen usually keep a bank account and can easily issue a cheque.

When the amount sent by the buyer is duly received by the seller, a *Receipt* has to be issued for the payment

A Receipt is a document acknowledging that some thing (goods or money) has been received A receipt for money shows the following particulars :—

(1) The date when money is received

(2) The name of the payer

(2) The amount received both in words and figures

(4) What the payment is for

(5) The signature of the receiver

Stamping —Law requires that a receipt for *more* than Rs 20 must bear a *revenue* stamp of *one anna* The receiver of money should make his signature on the stamp in such a way that part of it appears *on the stamp* and *part on* the paper

The cost of the stamp is borne by the receiver of money

In the following cases *no stamp is required* on receipts —

(1) A receipt issued by a banker for money received as a deposit

(2) Receipts issued by a Government Officer in payment of Taxes, Duties, etc

(3) A receipt given in acknowledgment of donations and subscriptions of a public nature

Kinds—A receipt may be *in full payment* of an account, or it may be *in part payment* The former is called a **'Receipt in full**, and the latter a **'Receipt on account** the wordings in both differ accordingly

Receipts are generally made out on printed forms having counterfoils

Note carefully the specimens that follow —

(Receipt for full payment)

No 39	No 39
20th Aug, 1930	DELHI *20th Aug, 1930*
Lala Pirbhu Dayal In settlement of a/c rendered 17th inst	*Received* with thanks from Lala Pirbhu Dayal the sum of one hundred and eighty seven rupees five annas and three pies only in full settlement of our a/c dated 17th August 1930
Rs 187-5 3	Rs 187 5 3 *Md Yakub Md Idris,* 1 anna Stamp
Md Yakub	

(Receipt for part payment)

No 39	No 39
20th July, 1930	DELHI *20th July 1930*
Lala Pirbhu Dayal on a/c.	*Received* with thanks from Lala Pirbhu Dayal the sum of rupees one hundred and fifty only on account of our statement rendered 17th inst
Rs 150/	Rs 150/ *Md Yakub Md Idris* 1 anna Stamp
Md Yakub	

A Voucher is any written paper, document, or *book in proof of the payment or receipt of money, or* one which in any way verifies the correctness of account or transactions

Receipts of payments are often pasted into a Guard Book, sometimes called the *Voucher Book*

A Cash Memo —In retail trade payment is usually made at the time the articles are bought, and so most shop-keepers issue for the receipt of money what is called a Cash Memo (short form of memorandum) It differs from a Receipt in that it does not mention the name of the buyer but simply gives the necessary particulars of the articles sold

It serves as a proof (1) of the payment having been made to the seller (2) that the articles have been actually bought and not stolen from some body's shop (3) When a person is asked to purchase some thing for another then he can show the Cash Memo to establish the truth of the price paid by him

Cash Memo

The Delhi Cloth Mills Co Ltd,
No 4167 Delhi 21st April, 1937

	Particulars	Rate	Rs as p
2	Saris No 501	2/1	4 2 0
1	Bed Sheet No 1330	1/8	1 8 0
1	Towel—No 35	/12/	0 12 0
			6 6 0

N B —Goods once sold will not be taken back

G S Pande,
Salesman.

Test Questions

1 What is an invoice, what useful purposes does it serve
2 What is a Pro Forma Invoice, when is it used? Give a specimen.
3 How are mistakes in Invoices usually corrected
4. Explain the nature and use of Debit and Credit Note giving examples. In what respects do they differ?
5 What is a Statement of Account when and how is it prepared? Show one
6 What is a receipt what is its importance? What sorts of Receipts do not require a stamp?
7 Write short notes on —
An Advice Note, A Guard Book, Firm Offer, Tender, Order, E. & O E an Export Invoice, A Voucher, an Indent.
8 How is payment for goods usually obtained? Name the various methods?
9 Suppose you have received Rs 253 10-6 from Pandit Ram Shanker Sastri in full payment of his debt. Prepare in complete form a receipt for it.
10. What is a Cash Memo, how does it differ from a Receipt? Prepare one

Practical Questions

1 Messrs Malik and Co., manufacturers of Games Material, Sialkot, have sold to Harnam Singh and Sons, Lahore, the following —

8 Tennis Rackets	at Rs. 14 each.
4 Tennis Nets	... at Rs. 19-8-0 each.
2 Doz. Tennis Balls	... at Rs. 5 8-0 per doz.
2 Doz Foot balls	.. at Rs. 5 8-0 per doz.

Expenses for Packing etc., and carriage respectively were—Rs. 1 2-6 and Rs. 3 10-0 Discount is allowed at 2½ %

Prepare an invoice for the above

2. Messrs. Bhagwati Prasad & Co, Booksellers, Aligarh, ordered from the National Stores, Fort Bazar, Agra, the following —

2 Doz Ink bottles	... at Rs. 3 4-0 per doz
16 Writing Pads	... at Rs. 1 2-6 each.
10 'Black Bird' Fountain Pens	... at Rs. 3 8-0 each.

Terms 2 per cent. trade Discount. Per Passenger train, carriage paid.

Prepare an Order in correct form

3 Supposing the goods as above were duly supplied. Make out an invoice Expenses being—
Packing—Rs. 9 6 0 carriage—Rs. 0-14 3
Write also the advice note

4. The Indian Stores, 12, Meston Road, Cawnpore, have sold to Messrs. Janki Prasad and Sons, General Merchants, Pilibhit —

2 Doz	Hair Brushes	... at Rs. 7-6-0 per doz.
3 Doz.	Felt Caps	.. at Rs. 48-0-0 per doz.
3 Doz	Sweaters	... at Rs. 36-4-0 per doz
½ Doz.	Hoses (Silk)	... at Rs. 14-8-0 per doz.

D scount allowed at 5%, and 1½% on cash payment within 15 days Expenses for packing and coolie respectively were —Rs 1 2 9 and Re 0 6 0 Goods were dispatched Per Passenger Train, carriage to be paid by the buyers on delivery Prepare the invoice

5 *The Furniture Supply Co. of Bareilly have supplied to Hamid* and Sons 12 Park Lane, Lucknow —

30 Tables	at Rs 10 8 0 each
3 Doz Chairs	at Rs 25 per doz
10 Office Almirahs	at Rs 32 0 0 each
5 Steel Safes	at Rs 47 5 0 each

Discount on safes and Almirahs at 5% Charges for packing and cartage Rs 5 8 0 and Rs 1 3 6

Make out in proper style an invoice for the above

6 Suppose the Almirahs in the above were to be charged at Rs 30 each How should the mistake be corrected? Prepare the necessary document

7 What is an Export Invoice how does it differ from an Inland Invo ce? From the following particulars prepare a Foreign Invoice —

Sold by Messrs Martin and Sons Manchester to Induljı Bahramji and Co Surat 30 Pieces of Grey Shirtings each 20 yds × 2 ft at 8d per yd *packed in two bales, marked thus*

and shipped for s s ' Union Charges Packing 7/8 carriage to Liverpool and Freight to Surat 10/9 Insurance, etc 14/6 commission at 2%

8 S N Bhatnagar and Sons Perfumers, Lucknow, had the following transactions with Hamid and Co Sitapur —

March 1 Sent a statement *to Ham d and Co for goods supplied* during February amount to Rs 19 10 6

March 4 Sold them goods value Rs 30 15 6
" 7 Hamid and Co returned articles value Rs 2 10-0
" 15, Sent *goods to them of Rs 13 4 9*
" 19 Sent C/N for overcharge of 5 as. 8 p in the invoice of 15th inst
" 23 Hamid and Co, remitted a m/o for Rs 20
" 27 Supplied goods value Rs 12 9 8
" 29, Received a cheque for Rs 40
" 30 Sent a D/N for the undercasting of invoice of 27th inst by *Re 1*

Make out in proper form a statement of a/c as on the 1st of April

9 Supposing the balance of a/c (in the above statement) is remitted in full settlement prepare in complete *form a Receipt for the same.*

CHAPTER XIV

Agents and Middlemen

In most trades, both wholesale and retail, transactions are settled and business is done not directly by the buyers and the sellers, but through the help of certain persons, commonly called **Agents.**

Need for Agents —In certain kinds of trades it is practically impossible to carry on business without the assistance or intervention of these *middlemen or intermediaries* as they are sometimes called

These middlemen help in moving the goods, in their onward flow, from the producer or manufacturer to the consumer In fact, it is they who arrange for the marketing of goods produced by others They generally act between the wholesalers and the retailers, and their main function is to bring the buyers and the sellers together on the market They settle the prices and other terms of transactions and undertake to carry these out on behalf of the real parties The agents by keeping themselves in close touch with the retailers are able to know their exact requirements They secure orders by showing the actual goods or their samples and price lists, and thus they help the manufacturers and wholesale dealers greatly in their business

So useful and so necessary are the services of these *middlemen* and *intermediaries* in the Foreign Trade that no business can be done at all without them

The student must be familiar with the way in which the local trade in cereals, cotton, sugar, etc., is carried on in our towns and cities. The farmers bring their produce to *Arahtias* (that is, the local Agents) who arrange for the sale, wholesale or retail, at the prices ruling in the market These Agents charge for their services either from the buyer or from the seller or from both, in accordance

with local customs of each particular trade. The producers resort to fixed agents according to their own facilities and connections

Meaning of Agency—The term 'agency' means the relationship existing between two persons or parties such that one of them is able to enter into contracts on behalf of the other, and also the acts of one are legally binding on the other It is based on the intention between two persons that for certain acts done by one of them the other shall be responsible.

It will thus be seen that an *Agent or middleman* is *one* who *buys or sells for others, or is entrusted* with the business of others The person for whom an Agent acts is known as his *Principal* or Employer

The terms arranged by an agent are binding upon his principal, provided they are made in the usual course of business Every manager, clerk, or workman in a business is thus as agent to some extent

A Mercantile Agent is therefore one who in the ordinary course of his business as agent has authority to buy or sell goods to consign goods for sale, or to borrow money for his principal by pledging the goods

Considered from the point of *authority* agents may be divided into two broad classes —

General Agents are all those persons filling posts or positions of a general nature and having authority to act in all matters pertaining to a certain business, *e g*, the manager of a firm or company A general agent has, in relation to third parties, full apparent authority due to his position or employment

Particular or Special Agents are persons employed to work in a particular capacity or for a particular job The principal is not responsible for the act of a particular agent if he does something beyond the scope or limits of his assigned duties

The nature and extent of authority of an agent may be defined in writing or implied from the circumstances or conduct

Kinds of Agents—According to the *work and duties* entrusted to agents they are classified as —

(*a*) **A Broker (or Dallal)** is an agent who settles a transaction between the buyer and the seller, or buys and sells any commodity for them The charge made by a broker for his services is called *Brokerage* (or *Dallali*) It is generally calculated at a fixed percentage on the purchase or sale price of goods He does not have actual possession of the goods, nor does he act in his own name, and so is not personally responsible for the contracts made through him.

(*b*) **A Factor** is an agent who buys and sells *in his own name* the goods belonging to his principal, he possesses as well as manages the property in goods belonging to others It is also his duty to keep his principal well informed of the market conditions from time to time, and to try to obtain the best possible terms for the principal The remuneration allowed to a factor for his services is known as *commission*

(*c*) **A Commission Agent** is one who does not possess the goods, but only their samples By showing these samples he secures *orders*, which are executed directly by the Principal He only gets commission on each order at a certain rate per cent He is really a Selling Agent

(*d*) **An Auctioneer** is a person who is authorised to sell goods at an auction. He charges a commission for his services, and can retain legal possession of the property entrusted to him for sale He must not only secure the best terms obtainable for his principal but also take proper care of the goods in his possession

An **auction** is a public place where the articles to be sold are '*knocked down*' to the highest bidder

The completion of a sale by auction of an article is indicated (rather used to be indicated) by the auctioneer by striking a bell with a small hammer, hence the term 'knocked down.' Before this any bidder may take back his bid, but not afterwards.

The price below which an auctioneer is not authorised to sell off a thing is known as the *Reserve Price* When there is no reserve price, that is, *Without Reserve* price, the highest bidder becomes the owner

The lowest price at which the bidding starts is called the *Upset Price.*

Bid is the offer of a price for an article, exposed for sale at an auction

Duch Auction or the "*Cheap jack*" is a method according to which the auctioneer starts the sale of an article at a higher price and gradually lowers it down till a sale is effected or the article withdrawn

(e) **A 'Del Credere' Agreement** is one by which an agent holds himself responsible for the payment of goods sold through him. Besides his usual commission, he makes an extra charge, which is known as the '*Del Credere*' commisson Such an agent is called the **'Del Credere Agent.**

Difference between a Broker and a Factor.

(1) A *Broker* deals in the name of his principals	(1) A Factor deals in his own name
(2) *He is not* personally responsible to the parties	(2) He is personally liable for his acts

(3) He is given the right of buying or selling goods, but not the right of possessing them	(3) He has the right of possessing as well as disposing of the goods of his principal
(4) He is employed for *a particular transaction only*	(4) He carries on the *business of his principal regularly*

Besides the above there are a few more types of agents whose services are utilised mainly in the Foreign Trade :—

Importing Agents, who import goods from abroad in accordance with the instructions of their principals

Cleaning Agents are those who are concerned with the work of taking delivery of goods at the ports, after undergoing the necessary *customs formalities*; and then *forwarding them to their principals living* in the interior

Exporting Agents, similarly, arrange at the ports for the export of goods of their principals, to foreign countries

Packing and Forwarding Agents are persons employed to collect and forward goods on behalf of others They are especially necessary in the consignment of goods abroad, though their services are indispensable to Home Trader sometimes.

A Contract Note is a short statement or memorandum sent by a broker or agent to his principal advising him *of the purchase or sale of goods* It contains a brief record of the transaction arranged by the agent

The Note which is sent to the buyer is called a **Bought Note,** and that sent to *the seller* is known as a **Sold Note** The following are the specimens :—

Bought Note

Sukha Nand Shiam Lal & Sons
Cotton Brokers,

Hathras 17*th March*, 1935

Messrs Jagjivan Murarji & Sons,
955, Kalbadevi Road, Bombay

We have this day bought for your account and risk 100 bales of ginned Cotton of L Harchand Rai Durga Das, Hathras

	Rs	as	p.
Cost of bales @ Rs 45	4,500	0	0
Add Our commission @ 2½%	112	8	0
	4 612	8	0

Delivery Prompt
Payment 5% cash

Shiam Lal,
for S N S L & Sons

Sold Note

Sukha Nand Shiam Lal & Sons
Cotton Brokers,

Hathras, 17th March, 1935

Seth Harchand Rai Durga Das,
Cotton Merchants,
Kila HATHRAS

Sold for your account at our public sale this day—

	Rs	a	p
100 bales of ginned *Cotton @ Rs 45*	4,500	0	0
Less Our commission @ Rs 2½%	112	8	0
	4,387	8	0

Delivery Prompt
Payment 5% cash

Shiam Lal,
for S N S L. & Sons.

A Consignment is a shipment of goods sent to an agent, chiefly in a foreign country, for being sold at the best prices obtainable The person who consigns goods is called the *Consignor*, and the person, to whom the goods are consigned is known as the *Consignee*

An Account Sales (A/S)—When a *consignment* is sold off, the factor or agent renders to the consignor a full statement of the sales made It shows the prices at which each lot of goods was sold, charges and expenses incurred, his commission (on the gross sales) and the net balance owing to the consignor It is prepared as follows —

Agent's Account Sales

ACCOUNT SALES of 40 Bales of Jute ex S S "Niagra" from Calcutta, sold by Merchant & Co, for account and risk of Messrs Warbeck & Sons Calcutta

		£	s	d	£	s	d
40 Bales Jute—							
	Tons						
Gross	365						
Tare and Draft	15						
	350 @ £2 1 0				717	10	0
Less charges							
Freight on 350 Tons @ 2/6		47	10	0			
Dock Dues		5	10	6			
Ware housing Exps		1	12	9			
Fire Insurance on £ 800 @ ¼%		2	0	0			
Commission @ 2%		14	16	0	70	19	3
Net Proceeds					646	10	9

Sydney August 7, 1935 *Merchant & Co*

Broker's Account Sales

ACCOUNT SALES of 40 Bales of Bengal Jute ex Steamer "Niagra" from Calcutta, sold at auction by other and for account of Messrs Warbeck & Sons.

		£	s	d	£	s	d
40 Bales June—							
	Tons						
Gross	365						
Tare and Draft	15						
	350 @ £2 1 0				717	10	0
Less charges		£	s	d			
Sales and Advt Expenses		1	11	6			
Brokerage at ½ per cent		3	11	6	5	3	0
	Net Proceeds				712	7	0

E & O E
Sydney 11th May, 1935

Merchant & Co.

Test Questions

1 Who are Agents or middlemen, what purpose do they serve? Give their classes

2 Name the chief mercantile agents and describe the functions of each

3 Is there any difference between the rights and duties of a Factor and of a Broker? Explain

4 What is a *Del credere agreement*?

5 Describe briefly how '*Dallals*' or Brokers arrange for the sale of cotton, sugar, wheat, etc in our local markets

6 Point out the difference, if any, between Discount and Commission

7 *Write a short notes on an Auction using the following terms* — *Reserve Price*, Upset price, Bid, and 'to knock down'

8 What is a Contract *Note*? *Prepare those used by a broker* when he has arranged a *transaction* between a buyer and a seller

9 What is an Account Sales when is it used? From the following particulars prepare one —150 Bales of coffee ex S S Nile from Jamaica, sold by T K Shah & Co, Madras, for and on account of Banner & Coats. Gross weight 140 tons, 6 cwt Tare and draf 34 cwt 2 qrs. sold at £ 3/3 per cwt. Charges Dock dues £ 2/1/6, Insurance £ 5/2, Freight £ 17/11 cartage £ 1/12/6 Auction Expenses £ 1/4, Bank charges, £ 1/6 Commission 2 $\frac{1}{2}$ %

10 On 23rd February, 1938 D Mora, & Co., of Delhi consigned per S S 'Himalaya 52 Tons of Oil seeds to the Eastern Trading Co., London, at Rs 9 8-0 per cwt. and paid Rs. 109 for expenses up to the time of shipment.

The consignee took delivery of the goods on the 29th March, and paid £ 14 10-6 for freight and £ 2 3-9 for warehousing etc. The same day they sent a Bank Draft for half the value of the consignment, taking a rupee equal to 1s 4d

The consignment was sold as follows —24 tons at £ 12/9/ per ton and the rest at £ 12 9 6 The consignee paid £ 1/5/ for Fire Insurance and £ 3/3 for Sundry Expenses They are entitled to a commission of 5 % on sales Prepare an A/S in correct form

11 Make out an A/S for the following goods sold by S Mahtab & Co, Lucknow, on behalf of the Bengal Shoe Manufacturing Co, Calcutta —

5 Cases assorted Shoes @ Rs. 35/8 per case,

3 Cases Non Leather Shoes @ Rs. 28/ per case,

Charges —Cartage Rs. 15, storage Rs 10,

Packing Rs. 5, Advertising Rs 8

Commission at 4 % on gross amount.

Terms 30 days sight Draft. Amount paid in advance Rs. 100

CHAPTER XV

Banks and Cheques

A Bank is a place where people (mostly the merchants) deposit their money and withdraw it when required, and where other financial and credit business in done A Bank receives deposits of money and allowes a certain rate of interest, and it lends the same money to those who require it at a *higher rate* This is why it is correctly said that "*a Bank deals in money*" that is, buys and sells the *use* of money, just as business men buy and sell goods The person who conducts the banking business is called a Banker.

The number of banks is very large in the advanced countries such as U S A, England and Germany where the system of banking is very highly organized

Kinds of Banks —There are several kinds of banks, *e g*, Commercial Banks, Industrial Banks, Co-operative Bank, and Exchange Banks *In the following* pages we shall confine our attention to *Commercial or Trading Banks* only

Functions of a Bank —A modern Bank carries on numerous functions relating to money and credit, the chief ones may be grouped as follows —

1 Receiving deposits of money in current and other accounts

2 Giving money (*a*) in the form of withdrawals from current accounts or (*b*) by way of loans, overdrafts, and cash credits

3 Discounting Bills of Exchange, Hundis, and Promissory Notes

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Note—1 **Overdrafts**—Sometimes a Bank allows a customer to draw out from his current account an amount in excess of the balance to his credit *The extent* of the amount so allowed is agreed upon and in most cases the customer has to pledge some security with the banker *Interest of course* is charged on the excess amount withdrawn

2 **Cash Credit**—In some countries *e g* Scotland, a Banker to help a customer places to his credit an agreed sum on the personal security of two or more guarantors The customer then draws out sums as required and pays *interest on the* amount actually withdrawn

4 Acting as a financial agent, by—

(a) Collecting and paying Cheques Bills of Exchange and other credit instruments, on behalf of its customers

(b) Issuing Bank Drafts ordinary and circular Letters of Credit

(c) Giving Trade Reference and supplying credit information

(d) Helping customers in the purchase and sale of Govt Securities Bonds Shares Debentures, etc

(e) Making periodical payments on behalf of its customers for insurance premiums subscriptions etc and collecting dividends on shares and interest on Bonds and Debentures, etc

(f) Taking charge of its customer s ornaments and other valuables for safe custody, and also acting as an administrator and executor at times

(g) Financing inland and foreign trade or making an advance on the basis of Invoices, Railway Receipts (or Bills of Lading) and other documents

5 Issuing Bank Notes In most countries important banks are allowed to issue their own notes, for instance the Bank of England Here in India so far only the Govt s Currency Notes are issued which are now managed by the Reserve Bank.

Kinds of Accounts—Two kinds of account are chiefly opened at a Bank—**Current Accounts** and **Deposit Accounts** **Savings Bank Accounts** and **Loan Accounts** can also be opened at most banks

A Currant a c or **Drawing** or **Open a c.** is one where money is placed and withdrawn by the customer at any time Generally speaking no interest is allowed on such an account and the customer is required to keep a certain minimum balance for instance Rs 500 by the Imperial Bank. If this balance falls below Rs 500 a charge of Rs 5 is made each half yearly

A Deposit or Fixed A c—In this account money is deposited either for a fixed period of 3, 6, 12 months

or more, and to be taken out on demand or on giving a notice to the banker.

Interest is always allowed on such accounts, the rate varying generally from $1\frac{1}{2}$ per cent to 6 per cent per annum

Note—**A House-Safe Account.** Some Banks have very recently adopted a new system for the sake of encouraging thrift among the public and thus collecting their small savings into sufficiently large sums The Bank supplies a small iron safe to his customer in which he can place money as saved The safe is sent to the Bank once in three months or so and the amount is taken out and credited to his Savings Account It allows interest at a small rate on such accounts

A letter is sometimes written to the bank when sending money for a Fixed Deposit, as follows —

Khurja, 10th April, 1935

The Agent,
Imperial Bank of India,
Khurja Branch

Dear Sir,

We are sending you herewith Rupees one thousand (particulars as under) to be placed in our name as a Fixed Deposit for six months at 4 per cent per annum

Please hand the Deposit Receipt for the amount to the bearer

Particulars —

	Rs
Cash	200
G C Notes	500
Cheques	300
	1,000

Yours faithfully,
Amolak Ram & Sons

Most Bank, however, supply their own special forms to be filled in by a customer who desires to place money in a Deposit Account

Application for Fixed Deposit

THE IMPERIAL BANK OF INDIA
(Branch)

No Sz

Khurja 10th Apr 35

Particular —

	Rs. a p	
Cash	200	Wanted a Fixed Deposit Receipt in favour of Amolak Ram and Sons for one thousand rupees only for 6 months at 4% per annum
G C Notes	500	
Cheques—on the Bank	300	
On other Banks		
	1 000 0 0	For Amolak Ram and Sons, (Sd) *Shanti Lal*

Each time a fixed deposit is made, a receipt, called a **Deposit Receipt** is given to the depositor

Fixed Deposit Receipt

THE IMPERIAL BANK OF INDIA
(*Not Transferable*)

No 13 Khurja, 10th April, 35

DUE 10th Oct 1935

Received from Seth Amolak Ram & Sons, Rupees one thousand only, as a Fixed Deposit, repayable six months after date with interest at the rate of 4 per cent per annum

For the Imperial Bank of India
(Sd) S L *Agarwal*,
Agent

Entered :—
G Chand *Cashier*
H Prasad *Accountant*

After six months when the money is withdrawn by the deposit this Receipt will be returned to the Bank duly acknowledging the receipt of money on its back as follows —

Received Payment—

	Rs
Principal	1 000
Interest	20
	1020

1 anna
For Amolak Ram & Sons
Shanti Lal
Stamp

How to open a Current a/c with a Bank

Generally speaking, when a merchant desires to open a current account with a bank for the first time, he has to introduce himself (if he is not already well-known) to the Manager or Agent through some old customer of the Bank or some respectable person. This introduction may take place either orally or in writing

The Autograph Book -When the Banker has decided to open an account of the customer, his name, address and occupation will be written in the Autograph (signature) Book The customer will be asked to make his signature in this Book, just in the same way as he would sign the cheques later on. A slip containing his signature will also be given to the Cashier for comparison with the signatures on cheques

Note —1 If it is a firm or partnership that desires to open an account, not only the firm's name will be written in the Signature Book, but also each partner will have to sign his own name This is because in a firm each partner can sign on behalf of the firm If only one or two partners are specially authorised to sign cheques this fact has to be mentioned at the time the account is being opened

2 In the case of a Joint Stock Company it is always the Director, Manager, or the Secretary who is legally authorised to sign cheques and such other documents

Three small books will then be supplied to the customer, free of any charge—(1) A Pass book, (2) A Paying-in Slip Book, and (3) A Cheque Book.

The Pass Book is a small ledger containing a copy of the Current Account of the customer in the books of the Bank. It has a date-wise record of all sums *received* and *paid* by the Bank on behalf of the customer Deposits into the Bank are entered in the Dr (debit) column, and withdrawals in the Cr. (Credit) column of the Pass Book. The balance is also shown from day to day.

This book remains with the customer, but at frequent intervals, it is sent to the Bank so that the account may be written up-to-date Below is a specimen of a Pass Book.

(*Current Account*)

Date		Particulars	Deposits Rs	a	p	Withdrawals Rs	a	p	Balance Rs	a	p	Initials
1935												
Jan.	3	To Cash	400	0	0	..			400	0	0	A B
"	8	To Cash	120	0	0				520	0	0	A B
"	10	By Cash (B. Ram Nath Shukla) ...				250			270			A, B
"	17	To Cash	150						420	0	0	A B
"	25	To Cheque (Imperial Bank)	40						460	0	0	A B
"	26	By Cash (Self)				50	0	0	410	0	0	A B
"	28	By Cash (Rent) ...				35	0	0	390	0	0	A B
"	31	By Cash (Income Tax)	...			45	8	6	334	7	0	A B
Feb.	1	To Balance							334	7	0	A B.

The Reconciliation Statement —At the time of closing the books of account a merchant compares the Pass Book with the 'Bank Account' as kept in his Cash Book Usually, the balance shown by the Pass Book does not agree with the balance of the Bank Account in the Cash Book The difference is often due to —

(a) Cheques drawn on the Bank may not have been cashed at the time the Pass Book was written up.

(b) Cheques paid into the Bank may not have been collected yet

(c) Bank charges, commission, etc, may have been shown in the Pass Book, but not in the Cash Book

(d) Interest allowed or charged by the Bank may have been entered in the Pass Book, and not in the Cash Book

To reconcile these differences a statement is therefore prepared It is known as the *Reconciliation Statement*

Example—Suppose on a particular date the balance shown by your Pass Book is Rs 1,161-5-0, whereas in the Cash Book it is Rs 1,064-15 0 You also learn that cheques issued to the following persons have not yet been presented for payment—

Ram & Co Rs 150,

Shiam & Sons Rs 175

And, the cheques as noted below were sent to Bank, but not yet collected—

	Rs	a	p
The Peoples Bank Ltd. ..	100	8	0
The Allahabad Bank Ltd	85	0	0
The Bank of Northern India .	30	8	0

The Bank charged Rs 18-11-6 as commission; and allowed interest Rs 6-1-6. They were entered in the Pass Book, but not in the Cash Book.

The Reconciliation Statement will be prepared thus:—

		Rs. a. p.
Balance as per Cash Book		... 1,054 15 0
Plus cheques not yet cashed		... 325 0 0
Plus interest allowed by Bank		... 6 1 6
	Rs. a. p.	1,386 0 6
Less Cheques not yet collected ...	216 0 0	
Less Bank Commission ...	18 11 6	234 11 6
Balance as per Pass Book		1,151 5 0

The same Reconciliation Statement could be prepared by starting with the Pass Book balance thus:—

		Rs. a. p.
Balance as per Pass Book		... 1,151 5 0
	Rs. a. p.	
Add cheques not yet collected ...	216 0 0	
Add Bank commission ...	18 11 6	234 11 6
	Rs. a. p.	1,386 0 6
Less Cheques not yet cashed ...	325 0 0	
Less Interest allowed by Bank ...	6 1 6	331 1 6
Balance as per Cash Book		... 1,054 15 0

Paying In Slip Book—This book contains small printed slips on which are entered the details of the money sent by a customer to the Bank for being credited to his account. These forms are also known as *Credit or Deposit Slips*. Generally, a credit slip has its counterfoil along with it, and it is signed by the cashier at the Bank to serve as a receipt for the money.

Specimen Credit Slip

No 3

Khurja Branch,
9th May, 1935

Paid in for the credit of *L Mukat Lal and Sons*, in account with the **Imperial Bank of India**

By **Mukat Lal**

	Rs	a	p
Cash—			
Gold			
Silver	180	0	0
G G Notes	300	0	0
Cheques—			
On the Bank	210	0	0
On other Banks	150	0	0
Hundies	500	0	0
Bills			
	1,340	0	0

Cashier G. Chand.

No 3

Khurja Branch,
9th May, 1935

Paid in for the credit of *L Mukat Lal and Sons* in account with the **Imperial Bank of India**

By **Mukat Lal**

	Rs	a	p
Cash—			
Gold			
Silver	180	0	0
G C Notes	300	0	0
Cheques—			
On the Bank	210	0	0
On other Banks	150	0	0
Hundies	500	0	0
Bills			
	1,340	0	0

Cashier G. Chand.

The Cheque Book—It contains printed forms of cheques 25 50 100 or more in each The forms are numbered serially and each is made up of two parts, the right portion (larger) being the *cheque* itself, and the left one (smaller) the *counterfoil*

At the end of the Cheque Book there is usually an Application Form, which is used for getting a new cheque book from the bank when all the Cheques in the book are used up

(Application Form)

1940

Date of Issue

No. ________ ________ *19* ___

The Imperial Bank of India.

KHURJA

Please deliver $\frac{\textit{to bearer}}{\textit{send by post}}$ *a new Cheque Book containing* ________ *forms*

Sig

Address

(*As a means of preventing possible fraud Customers are most urgently requested to use this order form when ordering a new Cheque Book*)

(Cheque Form)

(Counterfoil)

No

19

.

.

Rs ____

(Cheque)

No *Khurja* 19

THE IMPERIAL BANK OF INDIA, *(Branch)*

Pay *or order*

.

Rs ____

(Sig)

Whenever money has to be withdrawn from the Bank, one of the Cheque forms is filled up in ink, signed and sent to the Bank, or given to the person who is to receive money

Cheques

In all advanced countries cheques have become the '*businessmen's currency*', since they are the best medium of payment *for home transactions*. *In the big commercial centres of the world,* such as London, New York, Hamburg, Paris, Bombay, Calcutta, etc., payments worth crores of pounds or rupees are made *by means of cheques*. *Coins and Notes circulating* within a country are never enough for the requirements *of the businessmen and it is only through* cheques that they are able to carry on such a huge trade

Legal Definition of a Cheque—A cheque is an unconditional order in writing drawn upon a specified banker, signed by the maker, directing the banker to pay on demand a sum certain *in money to or to the order of a person named therein*

When analysed this definition means that a true cheque must fulfil the following requirements —

(1) That the *order* contained in the cheque must be *unconditional*, that is, there should be nothing like a condition or obligation attached to it

(2) The *order* must be *in writing* and clearly expressed.

(3) It must be drawn on a *bank* that really exists under the name mentioned

(4) It must be *signed* by the drawer or maker of the cheque

(5) The payment should be *on demand*, that is, just when the cheque is presented

(6) The sum to be paid should be a *definite amount*

(7) The payment should be made to the *person* whose name is mentioned in the cheque, or to the person who takes it to the bank

Thus, any document that fails to fulfil all the above conditions will not be regarded as a valid cheque in the eye of the law

Specimen Cheques

(1)

No 51	*No 51* *Delhi, 3rd May, 1935*
Delhi, 3rd May, 1935	**THE PUNJAB BANK LTD**
	Pay to me or bearer the sum of one hundred and fifty rupees only
For self	
	Juggi Mall Kamlapat
Rs 150	Rs. 150

(2)

No 86	*No 86*
15th December, 1935	*Khurja, 15th December, 1935*
In favour of—	**The Imperial Bank of India.**
L Ram Lal & Sons, in payment of our account	*(Branch)* Pay Lala Ram Lal & Sons, or Order rupees Two hundred only
	Mukal Lal & Sons
Rs 200	Rs 200

Parties to a cheque —Generally, there are three parties to a cheque —

(1) *The Drawer* is the person who draws, that is, writes and signs a cheque

(2) *The Drawee* is the Bank on whom the cheque is drawn

(3) *The Payee* is the person to whom the money is payable

Kinds of Cheques —Cheques are of two kinds—'Bearer and Order'

A Bearer Cheque is one in which the words '*Or Bearer* are written after the name of payee Such a cheque is payable to the bearer or holder of the cheque that is, to any one who may present it to the Bank

An Order Cheque is one in which the words '*Or Order* are written after the payee's name An

Order Cheque is payable to the person named in the cheque, or to some other person to whom the payee may like the money to be given

Note—Material Alterations are those involving any change in the date, amount, name of the payee place of payment, and the crossing of a cheque. The drawer alone can make (or allow to be made) any material alteration and the same should be initialled by him.

A 'Bearer Cheque' can be converted into an *'Order Cheque'* by any one of the parties, by merely striking out the word 'Bearer', but an 'Order Cheque' can be turned into a 'Bearer Cheque' only by the Drawer, who must initial the change.

If a banker pays a cheque having some material alteration and without proper initialing of the drawer, he does so at his own risk.

An order cheque requires an endorsement before it can be transferred or cashed.

[*To endorse* means to sign on the back of a document.]

Endorsement—The signing by the payee of his name (with or without other words) on the back of an *Order Cheque* is known as endorsement. It is necessary when the payee desires to cash the cheque or transfer his rights in the cheque to some other person.

The person who endorses a cheque is called the *Endorser*, and the person to whom the cheque is endorsed is called the *Endorsee*

Effect of Endorsing a Cheque—The legal title to a Bearer Cheque can be transferred simply by *delivery*, that is by handing it over to the transferee.

But in the case of an Order Cheque as has been pointed out above, it requires first *endorsement* and then *delivery*

The endorsee thus acquires full right of property and possession in the cheque and can also further negotiate or transfer it. But the endorser can, if he likes, restrict its further negotiation by putting down a *Restrictive Endorsement* as explained later on.

Thus when an Order Cheque is to be paid by a banker he would always be careful to see that it is properly endorsed, and if he rightly

obeys the instructions of his customer (that is the drawer) and pays the amount as directed the Cheque can be regarded as proof of payment

Forged Endorsement—If a banker pays innocently an Order Cheque, which *is regular in every respect but bears a forged* endorsement he is safe and the loss will fall on *the drawer or the endorser* This is because while a banker must know whether the drawer s signature is genuine or not *he cannot be expected to* know the *signature* or signatures of the endorsers

Kinds —An Endorsement may be—

(1) General or Blank, (2) Special or Full, (3) Restrictive, (4) Partial, (5) *Conditional or Qualified.*

In a *General or Blank Endorsement* the endorser merely signs his name, without mentioning the name of any particular person

A General Endorsement on the specimen cheque going before would appear as —

(Back of cheque)
Ram Lal & Sons
16 5 1935

In a *Special* or *Full Endorsement* the endorser writes above his signature the name of the person to whom he wishes *the money to be* paid, thus —

(Back of cheque)
Pay Lala Har Prasad Sheo Datt Rai,
Or Order
Ram Lal & Sons
16 5 1935

Note—After a General or *Blank* Endorsement an Order cheque becomes a Bearer cheque

A General Endorsement can, however, be easily turned into special by inserting the name of the transferee, above the signature of the transferor

In the *Restrictive Endorsement* the word '*only*' is added after the name of the endorsee, thus restricting further transfer of the cheque

(Back of cheque)

Pay L. Har Prasad Sheo Datt Rai, *only*.

Ram Lal & Sons.
16-5-1935.

A Partial Endorsement is one by which the endorser intends to transfer to the endorsee only part of the amount payable Or it may purport to transfer the amount to two or more persons separately. But such an endorsement is regarded as illegal unless it can be proved that the other amount has already been paid to the endorsee.

(Back of Cheque.)

Pay to Messrs. Har Prasad Sheo Datt Rai
Rupees *One Hundred only.
Ram Lal & Sons.
16-5-1935.

(*Suppose the above cheque was drawn for Rs. 150.)

Somtimes the endorsee is made the *agent* of the endorser by putting down some such words as—

(i) "Pay XYZ for my use," or

(ii) "Pay Mohan or Order for the account of Sohan only"

A *Conditional or Qualified Endorsement* lays down some condition For example, when the endorser of a cheque wishes to free himself from any liability, he uses the words **"Sans Recourse'** meaning without recourse to me

(Back of cheque)
Pay L Har Prasad Sheo Datt Rai,
Sans Recourse
Ram Lal & Sons
16 5-1935

Rules of Endorsements—

1 If in the body of a cheque the payee's name is *wrongly or differently spelt*, he should, when *endorsing the cheque, write the same*, spelling and then the correct one just under it, if he thinks fit. For example one Piarey Lal Sharma is the payee of a cheque, but his name has been spelled as Peare Lal Sharma He should endorse as follows —

Peare Lal Sharma

Piarey Lal Sharma

If he ignores the spellings of his name as given in the body of the cheque and writes in the endorsement those spellings which he is accustomed to, the endorsement will be wrong and the cheque will not be paid by the bank

2. Similarly, endorsements *in pencil*, though quite legal, are not recognised by bankers

An endorsement *by means* of a rubber stamp *is not enough unless* it is initialled by a responsible person and also *verified by the banker*

3 A cheque drawn payable to a married woman, (say Mrs William Brown) should be endorsed by her as follows —"*Jane Brown*, wife of W. Brown"

If a cheque is drawn in favour of a woman in her maiden name (say, Miss Mary Sykes) and she gets married in the meantime (say, to H. Smith) she should endorse by putting the word '*nee*' as "*Mary Smith (nee Sykes)*"

4. Cheques payable to Partnerships or firms should be endorsed by any one of the partners (or by one specially authorised) exactly as the name written in the body of the cheque.

For example, Messrs. Sharma Bros & Co., represented by (R. P Sharma, M S. Sharma, and others) will sign in the handwriting of one of the partners, as—

"*Sharma Bros & Co*"

5. Cheques payable to Limited Companies are endorsed by the Director, the Manager, or the Secretary as —

For The New Mercantile Co., Ltd.

H Kaicker

Secretary

(or Director, or Manager)

It should *not* be signed as—

H. Kaicker

Secretary (Director or Manager)

The New Mercantile Co., Ltd.

In the latter case it means that he is singing not on behalf of the company but in his personal capacity Such an endorsement will not be accepted by the paying banker.

6. A cheque payable to an illiterate person should by endorsed by him by putting his thumb-impression or other mark and attested by a witness.

7. Titles of courtesy and honour, such as Esq., Mr., Messrs., Miss, Mrs., Babu, Dr., Captain, etc., which precede the name of the payee, in the body of a cheque, should not be used in the endorsements. But titles and degrees added after the name are allowable.

Note—At this stage the student is advised to read carefully what has been said with regard to 'SIGNATURES' in the CORRESPONDENCE section of this Book

The following are the illustrative *Forms of Endorsements* —

Payee	Endorsements	
	Correct	*Incorrect*
Self (J C Chatterji)	*J C Chatterji*	*J C C or J Chatterji*
Selves (Gupta Bros & Co)	Gupta Bros & Co	Gupta Bros or Gupta & Co
Prem Mohan Tandon	Prem Mohan Tandon or P Mohan Tandon or P M Tandon	P Tandon or Tandon only
Har Gopal (illiterate)	His Thumb Impress on or *mark*— × *Har Gopal* Witness Jai Ram	Not his thumb *impression or* mark alone— ×
Dr Mangal Deo M B, B S	Mangal Deo or Mangal Deo M B, B S	Dr Mangal Deo or Dr *Mangal Deo* M B, B S
Prof S Kulkarni	S Kulkarni	Prof S Kulkarni
Capt Malikdad Khan	Malikdad Khan or *Malikdad Khan Capt*	Capt Malikdad or *Capt M Khan*
S K *Mukerji (wrong* spelling)	S K Mukerji, S K Mukerjee (right spelling)	S K Mukerjee
J Smith (now dead)	For J Smith, Henry Pattrick Executor (or Administrator)	Henry Patrick
Trustees of J Smith	For J Smith *C Murphie* J B Clark H Davidson Charles Smith } Trustees	Not signed by all the trustees individually

Payee.	Endorsements.	
	Correct.	Incorrect.
Miss. Kailash Mittal. (Now married to Mr A. C. Gupta)	Kailash Gupta (nee Mittal).	Kailash Mittal.
Mrs. J Kirloskar.	Lilawati Kirloskar, Wife of J Kirloskar.	Lilawati Kirloskar or J Kirloskar.
Hira Mal Bhagwan Das.	Hira Mal Bhagwan Das (by either of the partners).	Hira Mal, *or* Bhagwan Das.
The Union Trading Co Ltd.	For The Union Trading Co. Ltd. *P. C. Khare,* Secretary	P C. Khare, Secretary, The Union Trading Co. Ltd
The Central Bank of India, Ltd.	For The Central Bank of India, Ltd., *M P Verma*, Manager.	The Central Bank of India Ltd. or M. P Verma, Manager
The Secretary, Public Service Commission	For the Public Service Commission *J Sheldon,* Secretary	J Sheldon, Secretary Public Service Commission.

Honour and Dishonour of Cheques

Presentment for Payment—To present a cheque means to take or send it to the Bank on which it is drawn, and demand payment of the amount mentioned in it

The holder of a cheque must present it for payment as early as possible because if he delays unnecessarily, and the Bank fails in the meantime, the drawer is discharged from his own liability.

If banker pays cash for a cheque presented for payment, it is said to be '*honoured*', '*met* or '*taken up*'

But sometimes it happens that a cheque is *dishonoured*, which may happen owing to the following causes—

(1) *When there is not enough money in the* account of the Drawer to meet the cheque

(2) When the Drawer has become insane, or when he has died and the Banker knows this fact

(3) When the Drawer has become bankrupt (Devalia) and the Banker knows this

(4) When the Drawer (owing to some reasons) has himself asked the Banker not to pay This is known as an order of '*countermand*'.

(5) When words and figures of the amount differ, or there is some other irregularity in the cheque

(6) When a Cheque is *mutilated* or torn and pasted

(7) When a cheque is presented long after its date

(8) When the Banker has received a *Garnishee Order*

Garnishee Order—This is an order served by a court of Decree on a Bank prohibiting it from paying money belonging to the account of a person engaged in litigation, and who has been declared as a judgment debtor The order is issued by the Court, on the application of the creditor, and the whole balance in the account of the debtor is attached The bank, of course, is allowed to deduct from this balance any charges or debt due to him by the customer at the *date of the order*

Example—Suppose Mr X has to recover Rs 400 from Mr Y and he has obtained the decree against

him Now, learning that Mr Y has an account with a balance of Rs 500 with Bank Z, Mr X may obtain a Garnishee Order from the Court, requiring the Bank to pay the amount of the decree into the Court

If a Banker refuses to honour a cheque he indicates the reason on the cheque by writing one of the following short forms, and returns it to the holder —

R/D = Refer to Drawer
N/A = No advice
N/S = Not Sufficient Funds
N/F = No Funds.
I/F = Insufficient Funds.

Or he may write '*not in order*', '*irregular*', '*incomplete*', etc., as required

Relation between a Banker and his Customer So long as the customer has a credit balance in his account he occupies the position of the creditor, and the Banker that of the debtor But if there is a debit balance their positions are changed. Thus the general relation between a Banker and a customer is that of a debtor and creditor.

In the case of a current a/c opened by a customer, the Banker is bound to pay back the amount by honouring the cheques issued by the customer, up to the extent of the credit balance So, a Banker cannot refuse payment of cheques in the usual course, except for reasons pointed out above, otherwise he shall be liable for damages, as a dishonoured cheque generally affects adversely the credit of the customer

Similarly the Banker must obey the instructions of his customer, for instance, those relating to Crossing '*Order or Bearer*,' etc. If such instructions are disregarded by a Banker he cannot debit the account of the customer with the amount that he may have so paid. This means that a Banker is supposed to know correctly the customer's signature and if a cheque on which the Drawer's signature is forged, is paid by the Banker, he will have to bear the loss himself But not so if the endorsement is forged, and the cheque is in perfect order in other respects.

A Marked or Certified Cheque—Sometimes when a cheque for a rather large sum is received at a Bank, it is signed and returned to the payee, thus indicating that drawer has sufficient balance in his account

and the cheque may be presented for payment by a certain date when it will be honoured The Banker will in the meantime make arrangement to have the required cash to meet the cheque Some such words as '*Good for payment if presented before* are inserted by the Bank

A Cheque may be marked at the request of either (*a*) the drawer (*b*) the payee or (*c*) the collecting banker The effect of marking is that the cheque becomes more reliable

Notice of Dis honour—If a cheque is dishonoured the holder must give notice in writing to the Drawer or the Endorsers (if any) whomsoever he wants to make liable

It may be expressed as follows —

Notice of Dishonour

Mandi, Hapur,
21st December, 1935

L Mukat Lal & Sons,
Grain Merchants, Khurja

Dear Sirs
We regret to inform you that your Cheque No 86 value Rs 200 drawn on the Imperial Bank of India, was dishonoured when presented, Marked R/D
We enclose the said Cheque and must request for an early payment

Faithfully yours,
Ram Lal & Sons

If a Cheque is Lost or Stolen—Notice should be given at once to the Drawer, who will write to the Bank to stop payment It should also be advertised in the news papers, if possible

The lawful holder should then write to the drawer *asking him to issue another copy of the Cheque.* The drawer may, however, demand from the holder an indemnity against loss arising from the lost Cheque

Intimating loss of Cheque

Hapur, 21st Dec., 1935.

Messrs Mukat Lal & Sons,
Grain Merchants, Khurja.

Dear Sirs,

We regret very much to bring to your notice that your Cheque No 85 for Rs 200 on the Imperial Bank of India, has been lost. Please ask at once the Bank to stop payment and issue a duplicate of the same.

Yours faithfully,
Ram Lal & Sons

Crossings on Cheques

To draw two transverse parallel lines across the face of a cheque means to cross it. It is done to make a cheque more safe, since a crossed cheque is payable to the holder *not directly, but through some other bank only.*

Kinds.—Crossings on cheques are of two kinds—General and Special.

A General Crossing is that in which simply two transverse parallel lines are drawn through a cheque, with or without the addition of the words "... & Co." "*Not Negotiable*", etc.

Forms of General Crossing

(i)

No 86 Khurja, 15th Dec , 1935

The Imperial Bank of India

(Branch)

Pay L Ram Lal & Sons, or Order rupees two hundred only

Rs 200 Mukat Lal & Sons

(ii)

No 86 Khurja, 15th Dec , 1935

The Imperial Bank of India

& Co

Pay *Messrs Ram Lal & Sons or Order* rupees Two hundred only

Rs 200 Mukat Lal & Sons

(iii)

No 86 Khurja 15th Dec , 1935

The Imperial Bank of India

Not Negotia

Pay L Ram Lal & Sons, or Order rupees Two hund-ed only

Rs 200 Mukat Lal & Sons

(iv)

No 86 Khurja, 15th Dec., 1935.

The Imperial Bank of India.

Not Negotiable.
Account payee o[nly]

Pay L. Ram Lal & Sons, or Order rupees Two hundred only

Rs 200. Mukat Lal & Sons.

A Special Crossing is one where in addition to the parallel lines the name of some Bank is also written. The words "Not Negotiable," "A/c Payee only", etc., may or may not be used; and the name of the Bank may be written without drawing any lines at all.

Forms of Special Crossing.

(i)

No. 86 Khurja, 15th Dec., 1935.

The Imperial Bank of India.

The Allahabad Bank Ltd.

Pay L. Ram Lal & Sons, or Order rupees Two *hundred only.*

Rs. 200. Mukat Lal & Sons.

(ii)

No. 86 Khurja, 15th *Dec., 1935.*

The Imperial Bank of India.

The Allahabad Bank Ltd.
Not Negotiable

Pay L. Ram Lal & Sons, or Order rupees Two hundred only.

Rs. 200. Mukat Lal & Sons

(iii)

No 86 Khurja, 15th Dec, 1935

The Imperial Bank of India.

Pay L. Ram Lal & Sons, or Order rupees Two hundred only

Rs 200 Mukat Lal & Sons

The Allahabad Bank Ltd.
Account payee only

(iv)

No 86 Khurja, 15th Dec, 1935.

The Imperial Bank of India.

Pay L. Ram Lal & Sons, or Order rupees Two hundred only

Rs 200 Mukat Lal & Sons

The Allahabad Bank Ltd.
Not Negotiable
Under two Hundred rupees

Effect of Crossing—Crossing is a material part of a cheque and a cheque when crossed becomes more safe, because *it can be cashed through another Bank only*. The collecting Bank will do so naturally for his own customers, or for those persons who are well known. So if such a cheque proves to be stolen after it has been cashed, the Bank can easily find out the thief

Rules of Crossing—1 The drawer of a cheque may cross it generally or specially

2 If the drawer has not crossed it at all any subsequent holder may cross it generally or specially

3 If a cheque is crossed generally any holder may cross it specially.

4 If a cheque is crossed specially the collecting bank may again cross it specially to another bank for collection

"ACCOUNT PAYEE ONLY"—These words when written as part of a crossing, general or special, (1) serve as a notice to the collecting Bank that he should only credit the account of the payee with the amount collected and not pay it over at the counter. (2) They are sometimes also taken to mean that the Bank who has to collect the cheque should do so only if the payee has an account at the Bank.

Thus **a cheque is made quite safe** by drawing it *'to order'*, and *crossing it specially* with the addition of the words *'Not Negotiable,'* 'A/c Payee only, etc

An Open Cheque —An uncrossed cheque is called *an Open Cheque*

The Drawer alone can *open* a crossed cheque He should cancel the crossing and write *'Pay Cash,'* adding his signature thereto

Note —When cheques are sent by post they should be crossed always

A Forged Cheque is one on which the signature of either the Drawer or Endorser is forged

If a Bank pays a cheque on which the *Drawer's* name is forged, the loss falls on the Banker, because he is bound to know correctly his own customer s signature and hand writing

A Stale Cheque is one which bears a date long since past, usually six months Banks refuse to pay stale cheques

After a period of 3 years a cheque becomes valueless by law

A Mutilated Cheque is one which is torn worn out, or otherwise, disfigured It will be refused by the bank

Care in Drawing a Cheque — The first thing to remember is that the Cheque Book should be kept in a secure place, better under lock and key, if possible

In filling up or writing a cheque the following particulars should be carefully noted —

1 **The Date** should always be the same on which a cheque is actually drawn An *Undated* cheque cannot be cashed as it will be returned by the Bank marked '*Incomplete*' In this case the holder may insert any date which he thinks to be true

A Post dated Cheque is one which bears a date *after* the true time, *e g*, a cheque drawn on 12th December, 1935, may have been dated 14th December, 1935 It cannot be cashed until the 14th December

An Ante dated Cheque is one which bears a date *before* the true time, *e g*, a cheque drawn on the 12th December, 1935, may have been dated as 10th Decem ber, 1935 Now a cheque like this may or may not be refused by the Bank

2 **The Name of the Payee** should be written very clearly When money is with drawn for your own self or for Office use, write '*Pay self* (*or Selves*)

3 **The Amount** should be written both *in words* in the body of the cheque, followed by '*only*, and in *figures* at the left bottom *No space should be left after the words or figures expressing the amount*, for there is then some chance of forgery As for example, a cheque for pounds *six* (£6) if drawn carelessly, may be changed to *sixty* (£60) Therefore, to effect as a further safeguard, in the crossing there may be written *under six pounds*'

If the amount is altered by the drawer he should initial it

4 **The signature** :—The drawer should make his signature at the right-hand bottom, *just in the same way as he has done in the Signature Book with the Bank*

The *officer of a Company* should give his designation under the signature as —

(i) For The Capital Boot House,
Ram Lal,
MANAGER,

(ii) p p The Imperial Book Depot, Ltd ,
K M Banerjee,
SECRETARY

5 Before tearing the cheque out of the Book, enter in the **counterfoil** at least the following —
(*a*) Date, (*b*) Name of payee, (*c*) What the payment is for, (*d*) The amount in figures

Advantages of keeping Bank Accounts—Merchants as well as other persons derive several great advantages by keeping their accounts in Banks —

(1) By means of small slips, that is cheques money can be sent from one place to another with great ease and safety And the cheques which are paid away serve as a good proof of payment

(2) Money can be borrowed (on Loan a/c) from a Bank at a lower rate of interest Also Bills of Exchange can be discounted and Demand Drafts and Letters of Credit can be had from a Bank

(3) A Bank acts as an agent of the customer since it receives and pays money on his behalf, and also collects Bills and Hundies

(4) A Bank is a sort of referee with regard to the credit honesty and respectability of its customers It is also a source of much useful information to business men

(5) It is a safe place for the keeping of money, valuable documents, ornaments etc

(6) Traders can do more business with the help of Banks and thus the trade and industry of a country increase

Hence the larger the number of Banks in a country the richer it is

Test Questions

1 Define a Bank, and outline the nature of business done there

2 Name the kinds of accounts that can be opened at a Bank What difference do you note in a Current a/c and a Deposit a/c?

3 The Electric Trading Co of Khurja has sent Rs. 300 to the Allahabad Bank Ltd, *Aligarh to be deposited in a fixed a/c*, interest at 4 per cent. per annum Money to be withdrawn on giving a week s notice Prepare and fill in a proper deposit slip and also make out a Receipt for same

4 *Describe briefly each of the following books* —
(*a*) Autograph Book, (*b*) Pass Book, (*c*) Pay n Slip Book, and (*d*) Cheque Book

5 What is the object of a Bank Reconciliation Statement? Prepare one to illustrate your answer

6 Supposing you keep your a/c with the National Bank of India Ltd, Meerut draw and fill up a Credit in-slip for a total sum of Rs. 4,000 in coins, notes, cheques, etc

7 Define a cheque, and draw one for Rs 250 8-0, on the Peoples Bank Ltd, in favour of L Ram Das Shiam Das

8 What is a 'Bearer' and an 'Order' cheque, can the one be changed into the other, if so, by whom and how?

9 What is meant by '*endorsement*' on cheques? Name and explain its various kinds, together with the rules of endorsement.

10 When can a Banker rightly 'dishonour' a cheque? What words are used to indicate this, and what is the sense of each?

11 What is a '*crossing*', what is the significance of a crossed cheque? *Illustrate the different forms of crossings and their effect*

12 What is the exact sense of writing the words '*Not Negotiable*' in the crossing on a cheque?

13 Is a cheque as safe as cash, if not, how can it be rendered nearly so?

14 Are Banks really useful to the people, in what respects?

15 Explain shortly—Ante-dated and Post date cheques stale cheque, marked cheque, open cheque, and mutilated cheque

16 What precautions are essential in drawing out or filling in a cheque?

17 Is a Banker liable if he pays a cheque on which (*a*) the drawer's name is forged, (*b*) the Payee s signature is forged, (*c*) pays a crossed cheque at the counter, (*d*) pays a cheque bearing the words 'Not Negotiable' only

18 How should a cheque be endorsed in each of the following cases —
(*a*) Payable to an illiterate person, (*b*) payable to the wife of Mr D Swanson, (*c*) payee's name spelt differently, (*d*) payable to the Principal of the Pitman's College, Lahore

CHAPTER XVI

Bills of Exchange

Owing to the growth of the practice of buying and selling goods *on credit*, business people are always indebted to one another for large sums of *money*. These debts cannot be cleared in the usual manner, since—

(1) Coins or bullion cannot be sent easily from place to place. There are many chances of risk and danger.

(2) Currency Notes of one country are not accepted in another country.

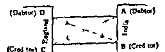
(3) Cheques cannot be cashed at every bank or at every place.

(4) It is always too expensive to use Money Orders for remitting large sums of money.

Hence, a system has been found out by which debts are cleared by exchange of debts. It may be illustrated as follows :—

(i) Suppose a merchant, named 'A' of Allahabad has 'B' his debtor for Rs 100, and 'C' as creditor for the similar amount, both living in Calcutta.

Now, 'A' instead of asking 'B' to send money to himself, and then sending the same to 'C', he may write an order to 'B' advising him to pay Rs 100 to 'C'. Thus the account of the three Parties will be settled without having to send money from one place to the other.



(ii) Again, suppose 'A' and 'B' are merchants in India, and 'C' and 'D' in England. 'A' is indebted to 'C' for Rs 1,000, and 'D' to 'B' for the same sum. Now, the easiest way of settling their account is that 'D' should pay Rs. 1,000 (or its equivalent in pounds) to 'C' in his own country, and get from him a written order on 'A' asking the latter to pay Rs. 1,000 to 'B' in his own country. 'D' will send this written order (Bill of Exchange) to 'B' who by showing it to 'A' will get the payment. Thus their indebtedness is cross settled and no money passes between the two countries, at the same time there has been much saving of expense, delay and trouble.

Such a written order exchanged between two or more parties to settle their accounts is known as a 'Bill of Exchange'. It has been legally defined as follows —

A Bill of Exchange *is an instrument in writing, containing an unconditional order, signed by the maker, directing a certain person to pay (on demand or at some future time) a certain sum of money to or to the order of a certain person, or to the bearer.*

It will thus be readily seen that when analysed (as already explained in the definition of a cheque) every word in the above definition carries a definite condition which must be strictly complied with if it is to constitute a complete Bill of Exchange. Thus an instrument that does not conform to this definition, or orders any act to be done in addition to the payment of money, will not be regarded as a Bill of Exchange in the right sense of the term.

The Essentials of a Bill of Exchange, therefore are —

1. It must be *in writing.*
2. It must contain *an order to pay.*
3. The order must be *unconditional.*

4 It must be *signed by the maker*

5 The *person* addressed to pay must be *certain*, that is definitely existing and called by that name

6 The amount payable must be a *definite sum*

7 The payment must be made *on demand* or at some *future* determinable time (A Bill payable at, say, one's marriage is indeterminable, because the marriage may not take place while the one payable on the attainment of a certain age or at death is determinable, because either of the two things is sure to happen)

8 The amount must be *paid to the bearer*, or *to a person named*

Its Importance—We have seen from the above illustrations that Bills of Exchange play a very important part in both home trade and foreign trade They fulfil the three basic requirements of business credit—**Security of debt, Liquidity of Funds**, and a good **Substitute for currency**

Modern business is built on the foundations of credit

The system of *credit* also implies 'trust or confidence', that is, while the retailer or the buyer must be allowed some time before which payment would not be asked, the wholesaler or the seller must be assured that the debt will be paid in due course

This is exactly what a Bill of Exchange does Because once a person has accepted a *Bill* drawn upon him he is bound to pay it when it falls due This is *security of debt*, being a legal proof of debt

Another great facility in the use of *Bills of Exchange* is that the holder can discount it with a Banker or Bill Broker, if he is in need of immediate funds. *This is liquidity of funds*

Still further, the holder might pass on the Bills of Exchange, he has received from his debtors, to his own creditors in payment of his debts Thus a Bill is a *substitute for currency* or circulating money.

Kinds—There are two kinds of Bills of Exchange—Inland and Foreign.

An Inland Bill of Exchange is one which is drawn as well as payable in the same country.

A Foreign Bill of Exchange is one which is drawn in one country but is payable in another.

Parties—Usually there are three parties to a Bill:—

The Drawer is the person who draws and signs a Bill He is the creditor.

The Drawee is the person who is directed to pay the sum of a Bill He is the debtor.

The Payee, is the person to whom (or to whose order) the money is to be paid.

He is the creditor of the Drawer.

Note.—Sometimes there are only *two* parties to a Bill; for example, when the Drawer asks the money to be paid to himself, he is the Payee also Below are the specimens of Inland Bills of Exchange —

Specimen forms of Bills.

No 27 *Delhi, 18th May, 1935.*

Rs. 1,200

On demand pay to us or order the sum of rupees one thousand and two hundred only, value received

To *Meattle Bros.*

Messrs B. Das & Co.,
Amritsar.

No. 135 *Lahore, 22nd February, 1935*

Rs. 500 4 0.

Stamp 9 annas.	One month after date pay to L Har Narain Gopi Nath or order the sum of rupees five hundred and annas four only, value received

To Khanna Mal,

Seth Shiam Lal, Bhagwan Das.

Gulzari Lal,

Delhi

How to draw a Bill of Exchange—An Inland Bill of Exchange may be written out on an ordinary piece of paper, but, as a matter of practice, printed *Bill forms* are generally used

Special attention should be paid to the following points, when drawing a Bill —

(1) **The Date** should be so written at the top right corner, that it may not be easily changed, because the period of most Bills commences from the date

(2) **The Term or Tenor** of a Bill is the period between the date of commencement and the date of payment It is also known as *'currency of a Bill'*

A Bill may be payable —

(*a*) *'On Demand*, *'At sight'*, or *'on Presentation'*, all meaning the same thing

(*b*) *'After Date'*—as '30 days after the date, (written as, 30 d/d) or three months after date,' (written as, 3 m/d)

(*c*) *'After sight*—'as '60 days after sight', (written as, 60 d/s), or 'two months after sight', (written as, 2 m/s)

(3) **The Amount** should be mentioned *in figures* at the left-top corner, and also in the body of the Bill, *in words.*

(4) **The Parties**—The name of the Payee should be written as ' . *pay to Messrs Brown & Sons, or order* ' When the Drawer is also the Payee, write " . . *pay to us or order* " or "*pay to self* (*or selves*) *or order*' The name of the Drawee, together with his address, should be written at the left bottom. The Drawer signs his name at the right bottom

"Value Received"—These words are added to the body of a Bill at the end They mean that the Bill has been drawn in exchange for something valuable (goods, cash or services) already received by the Drawee. This is called, in legal language, the *consideration* for a Bill.

(5) **Stamp**—All Bills of Exchange, excepting those drawn payable 'on Demand' or 'at Sight', require to be stamped *Ad valorem* (that is, according to value) as follows :—

Value.			*Stamp.*		
		Rs.	Rs.	a.	p.
Not Exceeding Rs. 200	...	...	0	3	0
Exceeding Rs. 200, but not .		400	0	6	0
,, ,, 400 ,, ,,	...	600	0	9	0
,, ,, 600 ,, ,,	..	800	0	12	0
,, ,, 800 ,, ,,	. .	1,000	0	15	0
,, ,, 1,000 ,, ,,	...	1,200	1	2	0
,, ,, 1,200 ,, ,,	...	1,600	1	8	0
,, ,, 1,600 ,, ,,	...	2,500	2	4	0
,, ,, 2,500 ,, ,,	...	5,000	4	8	0
,, ,, 5,000 ,, ,,	...	7,500	6	12	0
,, ,, 7,500 ,, ,,	. .	10,000	9	0	0
,, ,, 10,000 ,, ,,	...	15,000	13	8	0
,, ,, 15,000 ,, ,,	...	20,000	18	0	0
,, ,, 20,000 ,, ,,	...	25,000	22	8	0
,, ,, 25,000 ,, ,,	...	30,000	27	0	0

After this, Rs 9 more for every Rs 10,000 or part of that sum

Accepting a Bill—*After a Bill has been drawn it is* sent to the Drawee for being accepted by him who thus becomes a party to the Bill, and liable to pay it when due

A letter is usually addressed to the Drawee advising him of the Bill, somewhat as follows —

"*Dear Sir—We enclose herewith a draft on you for Rs. 500, the amount of our Invoice No 101 dated 15th Sept 1935, which please accept and return to us in due course.*"

The Drawee signifies his assent by writing the word '*Accepted*' across the face of the Bill, and under it he puts his signature and date It is not *legally necessary to write the word 'Accepted', mere signature of the drawee is enough*

The drawee is thenceforward called the *Acceptor*, and the Bill his *Acceptance* Before being accepted a *Bill is generally called a* '**Draft**'

The drawee of a Bill is allowed, in the usual course, 48 hours excluding holidays to accept (or not accept) and then return it

Acceptance by the Drawee is not necessary for Bills 'on Demand' or 'at Sight'

Kinds of acceptance—Acceptance may be General or qualified

A General Acceptance is one in *which the Drawee* agrees to the order of the *Drawer without making* any conditions or *qualifications*

He writes the word '*accepted*, and then signs under it Sometimes he adds also the place of payment, which is known as the **Domicile** of the Bill If no place is mentioned then it is payable at the acceptor's usual place of business.

Note carefully the following example —

1

No 27 Delhi, 18th May, 1935

Rs 500 4 0

Stamp
9 as

One month after date pay to L Har Narain Gopi Nath or order, the sum of rupees five hundred and annas four only, value received

Khanna Mal,
Bhagwan Das

To
Seth Shiam Lal, Gulzari Lal,
Lahore

2

No 13 Bombay, 10th October, 1935

Rs 500

Stamp
9 as

Three months after sight pay to us or order, the sum of five hundred rupees only for value received

To C Ram & Sons

Messrs Greenwood & Co,
Ahmedabad

A Qualified Acceptance is one in which the Drawee does not agree to the terms of the draft, but makes some conditions or qualifications

A qualified acceptance may be—

(1) *Local*, in which the Bill is accepted payable at some particular place and *there only* as—

"*Accepted payable at the Allahabad Bank Ltd, only*"

(2) *Partial*, that is, accepting the Bill payable for lesser sum, as—

"*Accepted payable for Rs 300*" (instead of Rs. 350, the amount of the Bill as drawn)

(3) *Qualified as to time*, that is, accepting to pay the bill after a longer time, as—

"*Accepted payable 6 months after date*" (the time in the Bill being 3 months after date)

(4) *Conditional* accepting a Bill on certain conditions as—

"*Accepted payable on selling off my goods, or on the safe arrival of ship etc*"

(5) *Acceptance by some of the Drawees, not by all*, *e g*, A Bill drawn on A, B and C, but accepted by *A or B only*

The Drawer or the Holder of the Bill may not agree to a *Qualified Acceptance*, he *may treat the* Bill as Dishonoured If such is the case, the Holder of the Bill should immediately give notice of it to the Drawer or the Endorser (or Endorsers), whomsoever he wants to make liable But if the Holder agrees to a qualified *Acceptance without the consent of previous parties*, they will be freed from all liability

Negotiation of Bills—The holder of a Bill may deal with it in three different ways —

(1) He may keep it till maturity and demand its payment from the acceptor on the due date,

(2) He may transfer it to one of his creditors in payment of his own debt

(3) He may discount it with a Banker or Bill Broker When dealt with in either of the last two ways it is said to be *negotiated* or *put into circulation*

A Bill of Exchange being a Negotiable Instrument, its rights can be transferred in two ways —

(1) By mere delivery, if the Bill is payable *to a* person named in it or *to the Bearer*

(2) By delivery as well as *endorsement*, if the Bill is payable *to or to Order* of a specified person

An **Endorsement** may be—

(1) General or Blank.
(2) Special or Full
(3) Restrictive, and
(4) Qualified.

Note —Each kind of these endorsements has been explained previously in the Chapter on Banks.

[*Allonge* When the back of a B/E is filled up with endorsements, and further space is required, a slip is attached to the Bill, and the next endorsement is so made that part of it appears on the bill and part on the slip This slip is known as an Allonge]

Maturity of a Bill —When the period of a bill is expressed as so many *'months after date,'* it matures on the same date of the month in which it falls due And if that month has no corresponding date, then on the last date of that month

Days of Grace —To arrive at the date of maturity, *three days more* are added to the period of every *Bill*, excepting those payable 'on Demand,' or 'at Sight' These days are known as Days of Grace They were allowed formerly to give the holder enough time for presenting it for payment, but now they have become customary

Example —A Bill drawn on the 28th December, 1929, payable 2 m/d, will mature on the 28th February,

1930, and with Days of Grace added, on the 3rd March, 1930

Similary, three other Bills drawn on the 29th, 30th and 31st of December, 1929, payable 2 m/d, will all fall due on the 28th of February, 1930, Days of Grace not being added

'*After sight*' means that the period is to be counted from the date on which the Bill *is sighted or seen* by the Acceptor, and not from the date on which the Bill is actually drawn—

Example:—A Bill is drawn on the 15th of February, 1930, payable 60 d/s, and it is sighted (or accepted) on the 8th of March It will mature on the 10th of May, Days of Grace being added

If the day on whch a Bill falls due is a public holiday it is deemed to be due on the *next preceding day* For instance, a Bill due on a Good Friday may be presented on Thursday preceding The Public Holidays are —

Sundays New Year's Day, X'mas Day, and Good Friday

Presentment for Payment—As a general rule on the due date a Bill should be presented for payment *at the place mentioned* in the Bill *during usual business hours* of the acceptor or of his Bank If this is not done, all the previous endorsers will be discharged from their liability, but not the acceptor himself

If no *domicile* is mentioned, the Bill should be presented at the usual *place of business* or *residence* of the acceptor

In case the acceptor has no fixed place of business or residence, the Bill should be presented *to him for* payment wherever he may be found

A Bill sent through the Post Office under registered cover, will be regarded as duly presented

Discharge from Liability.—The acceptor or endorser of a Bill is discharged from his liability by any of the three ways —

(a) *By Payment 'in due Course,'* that is by making payment on or after the maturity of the Bill just when presented. To signify that a Bill has been discharged, the holder simply cancels the Bill or writes on it the receipt for the amount and then delivers it to the acceptor

(b) *By Cancellation*—If a Bill is cancelled knowingly *by the drawer* and the cancellation is apparent, it is said to be extinguished

If *the holder* of a Bill intentionally cancels the name of the acceptor or any endorser, he is discharged from liability to such holder and all parties claiming under him

(c) *By Release*—The holder of a Bill may release or discharge the acceptor or endorser by not requiring him to pay, or by accepting only a part payment for the whole, or by accepting payment in some other form than cash

Honouring a Bill.—If a Bill of Exchange is paid in due course, that is, directly on presentation on the date of maturity, it is said to be 'honoured,' 'met,' 'taken up,' lifted,' or 'redeemed'

A Dishonoured Bill—A Bill is said to be *dishonoured* (i) if it is not accepted when duly presented, (ii) or if once accepted, it is not paid when duly presented for payment on maturity, (iii) or if it bears a qualified acceptance and the drawer does not like to consent to it

Notice of Dishonour—When a Bill is dishonoured for want of acceptance or of payment, the holder must send a *Notice of Dishonour* to the drawer and the endorsers, if any, as early as possible Any party not receiving such a notice will be discharged from his liability on the Bill

Delay in sending the notice is excused when it is caused by certain circumstances outside the control of the holder, and it may not be sent at all in certain special cases, given below.

The Notice of Dishonour is not necessary —

1 When it is not required by the party entitled to i ,

2 When the drawer himself has stopped the payment of the bill,
3 When the party charged could not suffer damages for want of notice,
4 When the party entitled to receive notice cannot be found,
5 When the party entitled to notice knows the fact, and promises unconditionally to pay the amount

Noting a Bill—The holder of a dishonoured Bill, after giving the Notice, should get it "noted" by a Notary Public. This is to supply a legal proof that the Bill was really presented and dishonoured, otherwise a holder neglecting to present the Bill in time and at the right place might sue the acceptor on the false plea of having presented it.

The *Notary Public*, is either a Government Official or a qualified Lawyer whose duty it is to certify dishonoured Bills. The Noting should be done within a reasonable time.

The Noting Ticket. The Notary Public himself arranges to present the dishonoured bill to the drawee, and if it is not accepted or paid even then, he notes upon a slip, (i) the date of dishonour, (ii) the reasons for dishonour, and (iii) his Noting Charges.

This slip is called the Noting Ticket. It is attached to the Bill and serves as an official proof of the demand having been duly made.

Note—The next step to Noting is Protesting, and it is explained later on in connection with Foreign Bills.

Order of Liabilities of the Parties—*The Acceptor* of a bill is primarily liable to pay a bill since he by putting his acceptance undertakes to pay it. If he does not honour the bill on maturity he is liable to be sued by the drawer, the endorsers, and a 'holder in due course.'

The Drawer is primarily liable so long as a Bill is not accepted, after which his liability becomes secondary. He shall have to compensate the holder or an endorser as a result of dishonour.

The Endorser.—The liability of an Endorser lies midway between those of the drawer and the acceptor. He shall have to compensate an endorser subsequent to him, if the latter has been compelled to pay for the Bill. At the same time he can recover, whatever amount he has paid, from the previous endorsers, the drawer or the acceptor.

The extent of *compensation* payable by any party liable is the amount of the Bill with interest at 6 per cent. per annum from the due date till the date of payment, plus all expenses properly incurred in noting and protesting etc

Circuity of Action means the endorsement of a Bill to some previous endorser a second time The effect of this is that the intermediate parties are then relieved of the liability to the holder, who endorses it to the previous endorser

Suppose a B E in the hands of Krishna has been previously endorsed by Sohan Rama Govind, Mohan and Gopal If Krishna now endorses it to Govind, the liability of Mohan and Gopal ceases.

Retiring a Bill—If the acceptor of a bill prefers to pay it off before maturity, it is said to be *'retired under Rebate'* He will be entitled to deduct interest from the amount of the bill at the market rate for the un-expired period of the bill. This interest is known as discount or Rebate.

Renewing a Bill—When the acceptor of a Bill is unable to pay it when due, he sometimes requests the drawer to extend the period of credit by drawing a new bill and cancelling the old If the drawer is satisfied as to the solvency of the acceptor, he may comply with the request In such a case the acceptor has to pay interest at the agreed rate for the extended period and also the cost of the stamp on the new bill

Drawee in case of Need—When the Drawer is in doubt whether or not the Drawee will accept the Bill (or having accepted, will pay it when due) he often puts down the name of another person as Drawee, to whom the Holder may go, if need be Such a person is naturally well-acquainted with the Drawer and is called a "*Drawee or Referee in case of Need*" The words usually take the following form—

'In case of need apply to Seth G. D. Birla,'

Suraj Mal Babu Lal.

The 'Case of Need' is generally mentioned in Foreign Bills for the sake of maintaining credit of

the drawer and also to save unnecessary delay and *expense*

Acceptance for Honour—When a Bill has been noted and protested after dishonour for want of acceptance or payment, any person (who is not a *party already liable on the Bill*) may come forward and accept the bill to save the honour of the drawer or any endorser, mentioning the name for whose sake it is being accepted This is called '*Acceptance for Honour Supra Protest*'

Similarly a Bill may be paid by a person as *Payment for Honour Supra Protest*

Payment cannot be asked however, from a person who 'accepts for honour', unless the Bill has been presented to the original drawee for payment when due and it has been dishonoured even then

Protest for Better Security—The holder of a Bill may ask the acceptor to give him a better security, if he has sufficient reason (acceptor's bankruptcy, failing business absconding etc) to believe that the amount will not be paid when due If the drawee fails to give a better security, then the holder may have the Bill protested for better security In such a case *Notice of Protest* will have to be sent to all the previous parties so that they may become aware of the probable dishonour of the Bill But the *acceptor is not bound legally always to give a better security* he may if he can

Lost Bills—If a Bill of Exchange is lost before its *term expires, the holder may request the* drawer to issue another bill of the same tenor and date But he will have to give security to the drawer indemnifying him against all *the parties should the lost bill* be found again

Forged Bills—Forgery cannot give a good title to any person So, if a *Bill* bears a *forged signature* either of drawer, acceptor, or an endorser, the transferee will acquire no rights on it even though he was not aware of the *forgery*

Foreign Bills of Exchange

A Foreign Bill is one that is drawn in one country but is payable in another, *e. g.*

(*a*) a Bill drawn in India and payable in Japan;

(*b*) a Bill drawn in Japan and payable in India; or.

(*c*) a Bill drawn in England and payable in Japan, but negotiated in India.

Set and Via—A Foreign Bill is generally drawn in a 'set' of three (or two, sometimes), and each one is called a '*via*' of the set. As soon as one of them is paid the others become valueless.

A Foreign Bill when drawn singly is termed a *sola* (single) Bill of Exchange.

The following is a specimen Set of a Foreign Bill:—

(1)

Stamp 15 annas	*Calcutta, 10th January, 1935.*
	Exchange for Rs. 975.

£65.

Sixty days after sight, pay this first of exchange (Second and Third of the same tenor and date unpaid) to the order of the National Bank of India, the sum of sixty-five pounds sterling for value received.

W. Benson and Co.

To

Messrs. Smith & Sons Ltd.,
London.

(2)

Calcutta, 10th January, 1955.

£65

Exchange for Rs 975.

Sixty days after sight, pay this second of Exchange (First and Third of the same tenor and date unpaid) to the order of the National Bank of India, the sum of sixty-five pounds sterling for value received

W Benson and Co.

To

Messrs Smith & Sons Ltd,
London.

(3)

Calcutta, 10th January, 1955.

£65

Exchange for Rs 975

Sixty days after sight, pay this Third of Exchange (First and second of the same tenor and date unpaid) to the order of the National Bank of India, the sum of sixty-five pounds sterling, for value received

W Benson and Co.

To

Messrs Smith & Sons Ltd.,
London.

The **term or tenor of a Foreign Bill** is usually expressed as so many Days (or months) after Sight, because in this way the length of distance or time taken in reaching the Drawee does not affect the period of the Bill

Usance—The period fixed by custom for drawing Bills between two different countries is known as

Usance It depends upon the distance and means of communication between the countries

The usance between India and England is '*60 days after sight* the same for India and Japan, and *90 days* between India and America

Protesting —When a Foreign Bill is dishonoured it requires not only *Noting* but also *Protesting*, so that the rights and claims of the Holder may be safeguarded against the Drawer and Endorsers (if any) living in the foreign country

A *Protest* is a solemn declaration, made by a Notary Public, of the following facts —

(a) The Bill or a copy of it

(b) The name of the party for whom and against whom it was protested

(c) That he presented the dishonoured Bill, either for acceptance or for payment

(d) That such and such is the answer received (actual words are given)

(e) That he formally protests against the refusal of the demand

It is attached to the Bill along with the Noting slip

Protest for Non-Payment

On the day of in the year one thousand nine hundred and , at the request of of I , Public Notary, by lawful authority and sworn, dwelling in , in the district of , in the United Provinces India, did exhibit the original Bill of Exchange whereof a true copy is on the other side written unto a clerk in the counting house of , the person upon whom the said Bill is drawn and demanded payment thereof, which demand was not complied with, and the said clerk answered

Wherefore I, the said Notary at the request aforesaid, did and do by these presents solemnly protest against the drawer and endorsers of the said Bill and all others concerned, for all costs of exchange re exchange and all costs, damages, and interest already incurred or to be hereafter incurred for want of payment of the said Bill

Thus done and protested at in the presence of

Witness

Seal

Witness

Notary Public

Difference between an Inland and a Foreign Bill —

(1) A Foreign Bill is usually drawn in a set

(2) An Inland Bill is written on a stamped paper (called Hundi Paper here in India) A Foreign Bill may be drawn on any suitable paper

(3) A Foreign Bill is stamped twice, once in the country where it is drawn and secondly, in the country where it is paid or negotiated

(4) A Foreign Bill, if dishonoured must be duly noted and protested while an Inland Bill may be noted, or may not Protest is not necessary for an Inland Bill

(5) The language of a Foreign Bill also differs a little, as will have been clear from the specimens given before

Difference between a B/E and a cheque :—

1 A cheque is drawn on a Bank while a B/E is drawn on a person, firm, or company

2 A cheque is used for inland payments only,

while a B E is used both for inland and foreign payments

3 A cheque is payable just when presented, but a B/E is payable on demand or after some time.

4. A cheque may be crossed, but a B/E is never.

5 When a cheque is dishonoured it is not necessary to sent a Notice of dishonour to the drawer; but it is in the case of a B/E

6 The drawer of a cheque is not discharged from liability, if the holder fails to present it for payment; both the drawer and the endorser are discharged in the case of a B/E

Test Questions

1 Define a Bill of Exchange, and illustrate how it can be used to settle the indebtedness between (a) three presons (b) four persons ?

2. Point out the importance of the use of Bills of Exchange in modern business.

3. Explain 'Drawer', Drawee' and 'Payee' in connection with a Bill of Exchange, and draw one to show their places therein.

4. What is the difference between 'a holder of a bill' and 'a holder in due course' ?

5 What is Tenor or currency of a bill, in what different ways is it expressed ?

6 'What is acceptance of a bill' ? Give its kinds together with illustrative examples.

7 What is 'Noting' a bill; when is a bill 'noted' ?

8 Who is a 'Referee in case of need' ?

9 Explain briefly —

'Value Received' 'Ad Valorem' Stamp, Draft, Domicile', Allonge, Noting Ticket, Returing a Bill.

10. What are 'Days of Grace, are they allowed on all kinds of bills ?

11 State whether the following will constitute a Bill of Exchange—

(a) 'Pay B Ram Das or order Rs. 100 on the date of his marriage

(b) 'One month after date pay to the manager of the Golden Cinema, whatever sum he requires'

(c) '30 days after sight pay A or order the price of 2 maunds of Sugar'.

12. How is the liability of an acceptor of a Bill discharged ?

13. State briefly the order of liability of the parties to a Bill

14 From the following particulars draw a bill of exchange —
Date 13th June, 1930

Drawers Hazari Lal, Gulzari Lal,
Timber Merchants,
Dehra Dun

Drawee The Krishna Hotel,
12, Creekh ll,
Mussoorie

Payee Ram Lal Shiam Lal and Sons,
Cloth merchants

Terms 30 d/d Amount Rs 740

15 The bill is accepted by the drawees payable at the Allahabad Bank Ltd *show the acceptance the stamp duty, and the due date of* payment

16 The Dhariwal Woollen Mills Co Lahore have sold goods to Seth Baij Nath Shri Nath Meerut to the value of Rs 535 10 0 to be paid *within 30 days at 5 per cent Cash Discount Only a few days* after the buyers, however have sent a bill for the amount due drawn on the National Insurance Co Lahore

Draw the bill and show the acceptance

17 How will the above bill be endorsed if the same is negotiated in favour of L Jamna Das, Bazaz of Amritsar ?

18 An inland bill is dated 1st March when will it fall due—

(*a*) if drawn at 60 d/d
(*b*) it drawn 3 m/d
(*c*) if drawn at 60 d/s and accepted on 15th March

19 A holder of a bill for £438 10s due in 3 months from now, *discounts it at 5 per cent per month* How much will he *receive ?*

20 Explain the sense of the term 'Acceptance for honour supra Protest ?

21 What is a Foreign Bill, how does it differ from an Inland Bill ?

22 What do you understand by Protesting' a Bill ? Describe *in full*

23 How is the term or tenor of Foreign Bills usually expressed ; from when does it commence ?

24 What is a Set of a Bill ? Give specimen forms of a full set.

25 How do you differentiate between—
(*a*) An Inland Bill and a Foreign Bill
(*b*) A Bill of Exchange and a Cheque ?

CHAPTER XVII

Promissory Notes And Hundis

Definition.—A Promissory Note (P/N) is an instrument in writing (but not a Bank Note or Currency Note) containing an unconditional promise by one person to another (signed by the maker) to pay on demand or at a definite future time a certain sum of money *to or to the order of a certain person or to* bearer.

Parties—A Promissory Note requires only two parties.

(1) The maker or Drawer of the Note, that is the *Promiser.*

(2) The Payee, or the *Promisee*

Joint and Several Liability.—A Promissory Note may be made by one person or by more, and their liability may be either joint or several

When the makers of a P/N promise to pay jointly, it is said to be a Joint Note; when they promise to pay singly, it is a Several Note. It is the wording of a P/N which tells whether the liability meant is joint or several or even both.

Study the examples following :—

1—Simple Promissory Note

Stamp 3 as.	Lucknow, 20th January, 1935.

Rs 100.

One month after date I promise to pay Messrs Murari Lal & Sons, or order the *sum of rupees one hundred only*, value received

Ram Lal Tiwari

2—Joint Promissory Note

Stamp
6 as

Cawnpore, 14th May, 1935

Rs 250

Three months after date we promise to pay L Ganga Sagar the sum of two hundred and fifty rupees only, for value received.

Harsaran Dass,
Ramsaran Dass.

3—Joint and Several P/N

Stamp
1 as.

Delhi, 30th January, 1935.

Rs. 50

On demand we jointly and severally promise to pay The National Insurance Co, the sum of fifty rupees only, value received

John Brown,
Smith Brown

4—Several P/N

Stamp
1 as.

Delhi, 30th January, 1935.

Rs 50

On demand I promise to pay the National Insurance Co, the sum of Rupees fifty only, value received

John Brown,
Smith Brown

Stamp Duty—Promissory Notes are stamped according to the schedule as below :—

(1) *If payable on demand*—upto Rs 250 — 1 anna.

Beyond Rs 250 upto Rs 1,000 — 2 annas

For other amounts — 4 annas

(2) *If not payable on demand*—The same as on a B E.

Note —Only postage stamps should be used for this purpose.

Difference between a B E and a P/N

(1) A B E is an *order* to another party to pay a certain sum,

A P/N is a *promise* by one party to pay a certain sum to another

(2) A B/E generally has *three* parties, A P/N has only *two*

(3) A B/E is drawn by the *Creditor*, A P/N is made by the *Debtor*

(4) A B/E requires *acceptance*, A P/N does not.

(5) The acceptors of a B/E can be liable *only jointly*,

The makers of a P/N may be liable *jointly or severally*

(6) A Foreign B E is drawn in a set, and when dishonoured must be protested, Foreign P N S are made singly, and need not be protested if dishonoured

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Hundis

These are Bills of Exchange written in Indian languages, mostly in *sarraf or muriya* characters Hundis have been used in this country by mahajans and sawkars from very old times, and they are governed chiefly by local trade customs

Hundis are written on special hundi-papers, bearing impressed stamps, the amount of which is the same as on Bills of Exchange.

There are two principal kinds of Hundis :—

(1) *Darshni Hundi*, which is a demand draft payable just on presentation

(2) *Miadi or Miti Hundi* is a bill payable after the expiry of the period mentioned in it, usually 60 days after sight.

Besides the above, two other kinds of Hundis are also sometimes used

(1) *Namjog Hundi* is one payable only to the person named therein, and it is not transferable.

(2) *Shahjog or Dhanijog Hundi* is a bill payable to a wealthy, respectable person or to a person who is supported by another wealthy, respectable person.

There are a few terms used in connection with Hundis, as explained below —

'*Sahi* When the Drawee accepts a Hundi he writes this word above his signature.

'*Pheri ai*' means that a Hundi is dishonoured

'*Bhari pai or Bhari gai* means that a Hundi has been duly paid

'*Khoti Hundi*' is one which is doubtful or forged.

'*Khoka-Hundi* means a Hundi which is paid or redeemed and is, therefore, no more of use.

'*Samachar*' is a letter of advice sent by the Drawer of a Hundi to the Drawee

'*Zikri Chitti*' is a letter written by the Drawer of a Hundi to his Agent or some other person requesting him to honour the Hundi, if it is dishonoured by the Drawee.

Specimen of a Hundi

CHUNNI LAL RATAN LAL, KHURJA

न० HUNDI—ON—DEMAND

सिद्धि श्री (हाथरस) शुभस्थानेक श्री पत्री भाई (गुरुमुखराय वासदेव सहाय जी) योग लिखी खुरजा से चुन्नी लाल रतन लाल की राम राम बचना, अपरंच हुंडी नग १ आप के ऊपर करी। रु० (पाँच सौ) अंकेन रु० ५००) के नीमे रु० २५०) के दूने पूरे देना। यहाँ रक्खे भाई (श्यामलाल अयोध्या प्रसाद) के मिती पौस बदी २। हुँडी पहुँचे तुरन्त रुपया साह जोग चलन बाजार टिकाना लगाय चौकस कर दाम देना।

हुंडी लिखी मिती पौस बदी २ सं० १९९१

द०—चुन्नीलाल रतनलाल

Explanation—The above is a Hundi on Demand and denotes the following particulars :—

Date—21st January, 1935 (according to English Calendar.)

Place—Khurja.

Amount—Rupees Five Hundred.

Drawers—Chunni Lal Ratan Lal

Drawee—Messrs Gurmukh Rai Basdeo of Hathras.

Payee—Messrs Shiam Lal, Ajudhiya Prasad

Hundi in Roman

CHUNNI LAL RATAN LAL, KHURJA

No . HUNDI—on—DEMAND

SIDH SHRI (*Hathras*) SHUBHASTANEK SHRI PATRI BHAI (*Gurmkhari Basdeo ji*) JOG LIKHI KHURJA SE CHUNNILAL RATANLAL KI RAM RAM BANCHNA, APRANCH HUNDI NAG 1 APKE UPAR KARI RUPAYA (*Five hundred*) ANKEN RUPAYA (*Rs 500*) KE NIME RUPAYA (*Rs 250*) KE DUNE PURE DENA YHAN RKKHE BHAI *Shiam Lal Ajudhiya Prasad*) KE MITI (*Fus Badi 2*). HUNDI PAHUNCHE TURANT RUPAYA SAHJOG CHALAN BAZAR THIKANA LAGAY CHOKAS KAR DAM DENA

HUNDI LIKHI MITI (*Paus Badi 2*) SAMAT 1991)

DASTKHAT (*Chunni Lal Ratan Lal*)

Advantages of the use of B/E

1 A Bill of exchange is safer than money, and minimises expense and trouble in its use

2 It is a legal proof of debt and it also fixes a time for its payment

3 Being a Negotiable Instrument a B/E can be used by several persons to settle their cross transactions

4 It increases the number of credit transactions and diminishes the use of large quantities of money (both coins and notes) resulting in a clear saving to the Government of a country

5 It teaches merchants the habits of being punctual, honest, and self respecting

All these advantages in turn help to develop credit, trade, and industry of a country.

Bank Drafts —A Bank Draft is a Bill of Exchange (generally on demand) drawn by one Banker upon another, asking him to pay a certain sum of money *to or to the order of a person named therein.*

Bank Drafts are used mostly for remitting money to foreign countries. They are particularly useful for travellers and tourists who do not like to carry cash along with themselves

1. Specimen Bank Draft

THE IMPERIAL BANK OF INDIA

No. 375

Rs 54-8-0 *Calcutta*, 10th February, 1935

On demand pay to the order of Mr. A. C. Chatterji Rupees fifty-four annas eight only, value received.

W. Nicholson,
Manager.

To

The Manager,
The Allahabad Bank Ltd,
Meerut

2. *Another specimen of a Bank Draft.*

A 18812

Under Thirty one Pounds Sterling

Imperial Bank of India

No. 12/1566. *Lahore 11th Oct. 1932.*

£ 30-0-0 *On Demand of this* **SECOND** *of Exchange (first unpaid) Pay to the Order of Students Bookshop Ltd the sum of Thirty Pounds Sterling*

Not Negotiable

Value received

To *For* **Imperial Bank of India.**

Imperial Bank of India

25 22, Old Broad Street, *Agent*

London, E C 2

Accountant.

Bank Notes —A Bank Note is a promissory note, payable on demand, and is issued by a Bank, especially authorised by the Government of a country, for instance the Notes issued by the Bank of England Here in India the Reserve Bank has now got this right of issuing such Notes on behalf of the Government They are called *Currency Notes*, and are of the values of Rs 5, Rs 10, Rs 50, Rs 100, Rs. 500 and Rs 1,000.

An I O U—It is a written acknowledgment of a debt, made by one person to another. The letters I, O and U have been substituted for the sound of the words '*I owe you*' An I O U does not require any stamp

Specimen I O U

Khurja, 5th December, 1935

To

Mr. Ram Behari Mathur,

I O U Ten rupees (Rs 10)

Bhagwat Swarup Saxena

Accommodation Bills.—An Accommodation Bill is one which is drawn, accepted, or endorsed without having received any value for it, but simply to assist a friend who temporarily stands in need of money.

Since such Bills are not real trade Bills, they are also known as "*Kites*," "*Windmills*," etc.

Documentary Bills.—A Documentary Bill is a Foreign Bill of Exchange having with it the necessary shipping documents, (Export Invoice, Bill of Lading, Policy of Marine Insurance, etc.) relating to a consignment of goods

These shipping documents are delivered to the consignee when he has either accepted or paid the Bill (according to terms of agreement, D/A or D/P.)

Note { D/A = Documents against acceptance.
D/P = Documents against payment.

Specimen Documentary Bill—D/P.

Manchester, 15th October, 1939.

£100.

Stamp 1s

SIXTY d/s pay this First of Exchange (Second and Third unpaid) to our Order, the sum of one hundred Pounds sterling, value received *against*—

four bales of superior Flannel, per S S. "Victoria," Documents attached to be surrendered on payment.

E M L
1/4
Bombay

To *Merchant & Co.*

The Elgin Mills Ltd.,
Cawnpore.

(Endorsement :—Pay to the Imperial Bank of India, or Order— *Merchant & Co*)

A Telegraphic Transfer (T/T) or cable Transfer is the quickest method of remitting money from one country to another The person desiring to make payment in a foreign country pays into a Bank of his own country the equivalent sum calculated at the current rate of exchange, together with the Bank's commission and charges The Bank sends a cable to its branch or other Bank in the foreign country directing it to pay the required sum to the person named

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The Negotiable Instruments Act —This Act prescribes the laws relating to the use of Bills of Exchange Promissory Notes, and Cheques, Hundis, though regulated mostly by local custom and usage, are also governed by this Act to some extent According to this Act a 'negotiable instrument' is one payable either to bearer or to a particular person or to his order But if the word bearer or 'order' is not added after the name of the person to whom it is made payable, then it is regarded as payable to that person or to his 'order'

Every such instrument is negotiable until its negotiability is restricted or impaired in some form, for example, by placing a 'restrictive endorsement' on a Bill of Exchange In such a case the payee cannot negotiate it further Similarly, the addition of the words Not Negotiable' in the crossing on a cheque impairs very greatly its negotiability

Thus, ordinarily, a Cheque a Bill of Exchange or a Promissory Note, is a Negotiable Instrument, but they are often made not negotiable by putting down certain special restrictions in the instrument.

Besides the above three there are some documents which, by business custom though not by law, are regarded as negotiable instruments for example, a R/R a Bill of Lading, a Dock Warrant, a Delivery Order, a Share Warrant etc The holder of such an instrument merely gets the right to sue in his own name and to recover the debt, but he cannot acquire a better title to it than that of the transferor They differ from the real negotiable instruments in that they cannot take the place of coins or currency

Material Alterations

A material alteration in a negotiable instrument consists of the following —

1 Alteration of the date made with the intention of increasing or reducing the period ,

2 Alteration of the sum payable ,

3 Alteration of the period for which it is drawn ,

4 Alteration of the place of payment, where mentioned ,

5 Any other alteration, for instance, the substitution or addition of the name of a new party, change of the rate of interest, if given.

Any such alteration, if made without the consent of the party whose interests are affected by the change, will not be binding on such party, unless of course it was made in order to carry out the common intention of the original parties. If such an alteration is made by an endorsee, his immediate endorser is discharged from all liability to him in respect of the consideration of the instrument. An alteration made by a non party has the same effect as made by the party.

The following alterations are permitted by the Negotiable Instruments Act —

1 Change from 'Order' to 'Bearer', by the rightful party,

2 Correction of a mistake, to be initialled by the party making it;

3 Crossing a cheque 'generally', if not crossed already; 'Specially', if crossed 'generally',

4 Converting a Blank endorsement into a special one,

5 *Addition of the words 'Not Negotiable' along with the crossing;*

6 Crossing a cheque second time by a banker to another banker, for collection.

7. Filling in of blanks in case of inchoate instruments.

If a material alteration is made in a negotiable instrument in such a way that it cannot ordinarily be detected, then the party (a person or a banker) who is liable to pay, pays it in good faith, according to its tenor and without negligence, will be discharged from all liability thereon.

The 'Holder' of a Negotiable Instrument is defined in the Act as any person who is entitled in his own name to the possession *thereof and* to receive or recover the amount due thereon from the parties thereto. So, there are two conditions laid down for enabling a person to acquire the rights of a 'Holder'—(1) He must be entitled to the possession of the instrument, though he may not be in actual possession of it, (2) He must also be entitled to receive or recover the amount himself. Thus according to the first condition an agent holding an instrument for his principal shall not become the rightful owner of the document, but he may receive its payment to be accounted to the principal. According to the second condition a person may be in possession of the instrument (e.g., a thief, or one who has found it somewhere) but be cannot legally obtain its payment, for himself. Hence, if a Cheque, a Bill or P/N is lost or destroyed its 'holder' is that person who was so entitled at the time of loss or destruction of the instrument

The Holder in due course is the rightful owner of a B/E and he acquires this position only when he has fulfilled the following conditions —

(1) That the Bill was *'complete and regular on the face'* when he took it, that is, there was nothing wrong or irregular in the instrument, and the endorsement, if any, was also genuine

(2) That he *took the Bill in exchange for something valuable*, which means money goods or service ,

(3) That it was *'not over due,'* that is, the *time* mentioned in the Bill *did not expire*, when he took it , and

(4) That he took it *'in good faith'* (*bona fide*) This means that he did not know whether the transferor's title to the Bill *(if it was transferred) was defective* , or that the transferor *himself* was not the true owner of the Bill , nor whether the Bill was dishonoured previously, if such was the case

The Holder in due Course can sue in his own name any or all the parties to a bill, and recover the amount from them, in spite of any defect in the title of the previous endorser or endorsers He should, however, act not only honestly, but also with diligence and caution

The **donee** of a negotiable instrument does not acquire the position of a 'holder in due course', as he does not receive it for value

A Holder for value *is the holder of a Bill for which value has* been paid at sometime by some one but not necessarily by him, e g , the donee of a Bill So, he differs from a Holder in due course in that the latter pays the value himself Further, the rights of a 'Holder for value' can never be better than those of the transferor If the *transferor's title is defective so will also be that* of the transferee who is the Holder for value

Inchoate stamped instruments—The Negotiable Instruments Act allows a person to deliver to another person a stamped and signed paper either wholly blank or having written thereon an incomplete negotiable *instrument He gives the holder prima facie* right to make or complete the instrument on the paper for any amount specified therein and covered by the stamp The person so signing becomes liable upon such instrument in the capacity in which he signs the same, to any holder in due course for such amount Not only the original holder but also a subsequent holder can fill up the instrument A mere holder for safe custody cannot, however, do so

Lost Instruments—If a Bill is lost or stolen the owner does not lose his title to it He can claim it from the finder or thief or any transferee provided that such a transferee is not a 'holder in due course In the latter case the loser has no remedy but to find out the thief and recover the amount from him But if a loser can prove that the person in possession of the Bill had a knowlege that it was a stolen Bill when he took it, then the holder is *in no better position than the thief* and must return the instrument to the loser

It is advisable, therefore, for the loser to notify the loss and prevent its being met on the due date, if possible

The loser of the Bill is entitled to demand payment of the Bill from the acceptor on the due date and to give notice of dishonour to all parties, if it is dishonoured. If he does not do so he loses all claims against the previous parties.

The loser can also demand from the drawer a duplicate copy of the instrument by giving him sufficient security to make good his claims, if the instrument alleged to have been lost is found and claimed by another person.

Period of Limitation

The period of limitation on a B/E or a P/N is three years, that is, no case will be entertained by a Court after 3 years from the last date specified for payment.

The period begins to run as follows —

1 On a B/E or P/N payable at a fixed time after date, from the date on which the Bill or Note falls due.

2. On a B/E or P/N payable at sight or after sight but not a fixed time, from the date on which it is presented and sighted.

3 On a B/E or P/N payable at a fixed time after sight, from the date on which the fixed time expires

4 On a B/E payable at a particular place, from the date on which it was presented at that place

5 On a P/N given by the maker to a third person to be delivered to the payee after a certain event should happen, from the date of the delivery to the payee

6 On a dishonoured Foreign Bill, where protest has been made and notice given, from the date on which the notice is given.

7 On a B/E dishonoured by non-acceptance, from the date of the refusal to accept.

8 On an Accommodation Bill from the date on which the acceptor pays the amount of the Bill.

Liability of a Union.—The capacity to contract is *determined* by the personal cases of different individuals. Any person competent to contract may bind himself or be bound by drawing, accepting, endorsing and delivering a Negotiable instrument.

A minor, however, cannot bind himself personally, though he may bind all other parties to it by becoming a party of the instrument.

Liability of a Corporation.—A corporation, being an impersonal body, has no power to become a party to a bill *unless, of course, empowered by the law under which it has been incorporated*

Liability of an Agent.—A general authority to transact business and to receive and discharge debts, does not confer upon an agent

the power to accept or endorse bills of exchange so as to bind his principal *Again, an authority to draw bills of excharge does not of* itself give an authority to endorse Therefore, an agent who signs for his principal, without intending to incur personal liability, should be careful to indicate on the face of the instrument that he signs as an agent only

When any person signs in his trade name, he is liable in the same way as if he had signed his own name But a partner, acting within the scope of his authority, signs the name of the firm, the firm is liable *And when there is no clear indication in the signature made* by an agent that he is signing for his principal the agent will be personally liable This position is not altered even if the agent gives *his descriptive title to the signature, for example, in signatures such as,* "B N Mitra, Agent, S Martin and Co" or "B N Mitra, Secretary, North Western Sugar Factory Ltd," Mr B N Mitra is personally liable But if he signs "S Martin and Co, B N Mitra, Agent", or per (or for) North Western Sugar Factory, Ltd., Secretary, he is free from any personal liability

Test Questions

1 Define a Promissory Note, and point out how it differs from—

(a) A Bill of Exchange
(b) A Cheque
(c) Government Currency Note

2 What is meant by 'Joint' and 'Joint and several' liability of a P/N ? Show the examples

3 What is a Hundi ? Name and explain its main kinds

4 Write short notes on —

'Via' of a Foreign bill, Usance, Allonge, 'Samachar,' 'Zikri Chitthi,' Sola Bill, Bank Note, and a T/T

5 Define a Bank Draft When it is specially useful ? Give a specimen of it.

6 What is an "I O U", how does it differ from a P/N ? Draw *one to illustrate your answer*

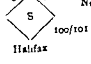
7 What is a Documentary Bill, when is it used ?

8 Discuss the advantages and disadvantages of the use of Bills of Exchange

9 Drawers H Hamilton & Co, New York

Drawees P Paterson & Sons, Halifax

Draw a Documentary 30 days sight draft for 120 dollars, the value of 2 cases Glasswares, *marked as*



shipped per S S "Victory," by Messrs Thornton Bros, New York to the Royal Hotel, Halifax

10 Messrs. A Harrington & Co of Liverpool, owe to The Eastern Trading Co., of Madras Rs 405 You are required to draw in proper commercial form, a bill of exchange (second via), dated 2nd April, at 60 d/s, in settlement. Rate of Exchange £=13½ rupees.

11. L. Baij Nath Bal Mukand of Amritsar borrow from Messrs Tandon Bros. & Co., *of Ludhiana a sum of Rs. 300. Show a P/N*, first 'joint' and then 'several', for the amount.

12. Suppose an I O U is given for the above loan, show how it will be worded

13 Calculate the amount of stamp duty required on—

(a) *A bill for Rs 275 at 3 m/d.*

(b) A bill for Rs. 300 at 7 days after sight.

(c) A P/N for Rs. 75 payable on demand.

14 The National Bank of India Ltd., Dehi, draws a bill on the Punjab Bank Lahore, for Rs. 250, in favour of Pt. Hira Lal Khanna, Prepare it

15 Write out a Hundi (on demand) for Rs. 700, drawn by L. Kishan Pal, Prem Narain of Calcutta on Seth Suraj Mal of Khurja.

16 Give the definition of a Negotiable Instrument and bring out its exact nature.

17. What are material alterations ; what is their effect ?

18 How do you differentiate between a holder and a holder in due course ?

CHAPTER XVIII

Home Trade

A reference to the Occupation Chart given in the beginning of this book will show that Trade is that part of commerce which is concerned with the purchase and sale of goods It is easy to understand that mere production of goods is not sufficient to satisfy our wants The producer or manufacturer of goods does not do so for the satisfaction of his own wants as used to happen in earlier times He now collects or prepares things to be exchanged with other things produced or made by others Each person or group of persons, now-a days, follows a different occupation, and exchange of each one's product or services is necessary so that all of our wants and needs be completely satisfied

Barter and Money—*There was a time when goods* were exchanged directly for goods, because there *were not many things to part hands, as man lived* a simple life with only a few wants to meet This kind of exchange is called **Barter** Human wants and needs have now multiplied and, consequently, the number and variety of goods to be exchanged have also grown vast **Money** has, therefore, to be used now as a medium of exchange by all civilized peoples of the world Goods are first given away for money and then with money they acquire other goods and personal services

Kinds of Trade

- Home
  - Wholesale
  - Retail
- Foreign
  - Import
  - Export

Trade may be divided into **Inland** and **Foreign**

The buying and selling of goods carried on within the limits of a country is known as its **Inland or Home Trade**, and the trade carried on between two or more countries is their **Foreign Trade** Foreign trade consists of the Imports and Exports of a country, and is also known as its external trade

There are also a few other kinds of trade as follows —

Overland Trade—This is trade carried on between two or more adjoining countries by land routes, for example, between India and Afghanistan, China and Tibbet, etc

Coasting Trade—It means trade conducted amongst the sea ports of the same country, *e g.*, between Rangoon and Calcutta, Madras and Colombo, etc.

Local Trade—This is an idea of trade on a very small scale, *e g*, the daily buying and selling that takes place in the grain or such other market of a town or city

Home Trade is of two kinds—

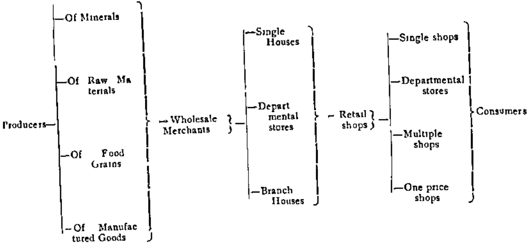
Wholesale Trade, which means the buying and selling of goods in large quantities

Retail Trade, means trade in small quantities of goods

Flow of Goods—Things required for the various needs of man are collectively termed *'goods'* First of all goods are produced or manufactured—by hand or by machinery—in very large quantities They are then sold to whole sale merchants or large stock-keepers at wholesale prices in the big markets or Mandis The wholesalers next sell them to Retail merchants or ordinary shop keepers These in turn sell at retail prices to consumers, who themselves use the things

This is the general order in which goods reach the public, but now-a-days consumers or users of things can buy goods directly from the wholesalers, provided they order in sufficiently large quantities

Flow of Goods



These two classes of persons—the Wholesale-trader and the Retail trader—perform very important functions in the organization of trade carried on these days —(a) The growers or makers of goods cannot possibly arrange for the sale of their products directly to the consumers of those things They have already too many details of their own particular work to look after The **Wholesalers** come to the help of the manufacturers in this respect (b) It is the whole alers again who direct the manufacturers as regards the kind or quality of goods to be prepared. (c) They possess ample funds and can easily extend credit to the Retail dealers (d) They hold large stocks of different varieties of goods and can regulate the prices by controlling the supply

Similarly, the **Retailers** are useful in their own way (a) They are in close touch with the consumers and knowing their exact wants and requirements can prompt the wholesalers to ask the manufacturers to produce only those goods and those grades or varieties that are in current demand (b) They bring the goods to the very door of the consumers and thus save them from otherwise a great deal of trouble in getting their requirements straight from the producers (c) They also introduce new kinds of goods to the users (d) Their sales being usually for cash money, they inculcate amongst the buying public the habits of saving and paying for their daily requirements

In fact it is due to the close and regular connections of the manufacturers or producers the wholesale merchants and the retail dealers that the needs of each and every individual of modern society are being fulfilled completely and most easily

Forms of Business Ownership

Business both wholesale and retail is carried on these days under several forms each differing from

the other in its kind of ownership and nature of organization The following are the chief forms :—

One-man business is that business which is exclusively owned and carried on by a *sole trader* The proprietor, who is generally the head of his family, may be assisted in his work by the sons, brothers, or even other male members The shop or business-house is usually named after the proprietor and the eldest of one of the sons or brothers Much of the retail business is done in this way

Partnership —When two or more persons (not exceeding 20) unite together their capitals, goods or other possessions, and also their labour and skill for the purpose of carrying on a common business, it is called a *Partnership* or *Firm*, and each person composing the firm is known as a *Partner*

In India the Family Partnership is the most usual form of business ownership It consists of a few members of a family, or near relatives or even friends and each contributes a definite sum towards the capital of the firm and each shares in fixed proportions the gains and losses of the business Much of the retail and also wholesale trade is carried on by partnership firms

The mutual relations of Partners are regulated by the terms of the **Deed of Partnership**, and in other matters they have to follow the Partnership Act

Joint Stock Company is an association of persons, each one of whom holds a certain number of shares in the capital of the Company, such capital being contributed by the share holders themselves The shares are transferable and the liability of each share holder is generally limited to the extent of the value of his shares A Joint Stock Company must comply with the regulations laid down in the Companies Act

Large scale business, industrial or commercial, is possible only under the form of Company ownership, because it not only enables huge capital to be collected for running such businesses but also avoids the risk of heavy losses to be borne by a few individuals as happens in the case of a Partnership Further, a Company can continue for any indefinite length of time, while a Partnership has to be dissolved on the death or retirement of a partner.

Types of Retail Shops—Retail business is usually conducted by shop-keepers or small merchants adopting one or other of the following systems of sale—

1 **A Single Shop**—Here the owner or head of the business deals personally with the customers as they visit the shops to purchase things of their daily requirements Though prices are supposed to be already fixed for each particular article, it is not unusual (at least in India and other Eastern countries) to agree to the final price after some higgling and bargaining on both sides

Another variety in the same line is what is termed a '*one price system*' where cheap articles of the same class or of related classes are displayed in tastefully decorated shops, and each article or one of the same group is sold for the same fixed price Articles of dress and toiletry, children's play things, etc, costing a few annas each are generally sold in this way in most big cities

2 **A Departmental Store**—With a view to provide customers the facility of purchasing most of their requirements from the same business house, the practice of opening several departments situated in the same building and under the same ownership and management is growing rapidly in big cities where population is large enough and markets are scattered They generally occupy a central place on the crossing of streets and roads

Here each department has got a room for itself and it is stocked with goods of one class, *e g*, one department sells Cloth and Dress material , one, articles of General Merchandise another, Books and Stationery and still another, Food Provisions, etc France is the original home of departmental stores

3 **A Multiple Shop** means a large scale retail business having a number of branches within the same town or city, the same country, or even in other countries Each branch is managed by a branch-manager, and the whole business is supervised by a General Manager The goods are stocked at the Head Office and they are sent to the Branches in small lots to be retailed for cash The business is generally owned by a Company

This system is based on the idea of supplying well known article or articles close to the customer's home or place of work This saves much time and also travelling expenses of those who happen to live at a distance from the main part of a city This also avoids the middlemen s profits and so the price is kept within reasonable limits

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Methods of Business Expansion

In modern competitive trade it is not enough to start a business and then rest content with whatever custom is secured in the usual way Both in the wholesale and the retail trades several methods have to be adopted for introducing new business, and for attracting more customers to extend further business

The principal methods employed for this purpose are as follows though they differ considerably according to the size of business nature of trade, and the customs and manners of the particular people for whom they are meant —

1 **Window Dressing** —In the retail trade the neat and attractive display of goods in windows and

shop fronts has become a regular art This arrangement is usually met with in shops dealing in fancy goods and dress material The one price shops also take good advantage of this method, because it possesses a great attractive force in drawing the attention of the passing crowd

2 **Trade Fairs**—In earlier times when means of communication and transport were not developed, fairs were the chief source for the purchase and sale of goods in nearly every country Some of the fairs of those days lasted for months and traders and merchants of different nationalities met there Till recently in India the weekly or bi weekly '*painths* or '*hats* held in villages were nothing but fairs on very small scales But the fairs now held are mostly religious in their essence, although a good deal of buying and selling is done there also

3 **Exhibitions**—Originally, exhibitions were meant to serve the purpose of education and information for the masses But, later on, their chief aim has been to introduce new goods and especially works of art and design Merchants and manufacturers come from distant places and display their own particular goods in the stalls, so arranged that goods of one class or group occupy one row or line of stalls

'*Swadeshi*' Exhibitions are a regular feature in India these days and are being organized on very grand scales in the principal cities of the country. Here mill made products as well as works of real art and design or fine articles of delicate workmanship are exhibited, and thus provide a definite idea as to the country's industrial progress

Sometimes world exhibitions are organized by interested countries, for example the *Wembley Exhibition* of London held some years ago

4 **Markets and Exchanges**—A market is a meeting-place where buyers and sellers transact their business

Sometimes this term indicates a large trading centre or port, e g, Amritsar for wool and grain, Karachi for wheat, Bombay and Liverpool for cotton; Calcutta for jute, Delhi and Bombay for Bullion, etc.; and money market in Lombard Street, London

Similary, there are other important markets for other chief products or goods, either grown or manufactured in the neighbourhood of the place or collected for wholesale trade They are generally called Exchanges or *Mandis* For dealing in shares and stocks there are other markets known as *Stock Exchanges*, for instance Calcutta and Bombay in India, London in England, and New York in U S A

In these markets and Exchanges business is transacted usually through brokers and agents, and besides serving as convenient meeting places for buyers and sellers their chief function is to regulate prices The prices ruling in these markets are published in newspapers, in the name of '*Market Reports*' A study of these reports enables businessmen to know whether prices are rising or falling and what their likely tendency is in near future

5 **Salesman-Travellers**—Big retail and wholesale firms send out, at regular intervals, travelling salesmen and agents who go on touring through important places They visit all likely buyers of their wares or articles and secure orders by showing samples and designs of those things together with descriptive literature

They also study the exact requirements of the places visited as regards fashions, customs, and general outlook of the customers and send regular reports to their employers giving them full instructions for meeting the requirements, real needs, or mere whims of the buyers of particular localities

The chief advantage of this method of approaching customers is that the salesmen can discuss with the

customers all the details and explain all matters in the best possible manner, and thus establish a sort of personal contact between the business house and the customers

6 **Advertising**—Due to keen competition amongst businessmen and for bringing new products to the notice of the buying public advertising in one form or other has become part and parcel of modern business In all advanced countries, and especially so in U S A., England and Germany, they spend huge sums on Advertising with very good results In India and other countries too business men have learnt the secret of wide publicity.

The main purpose of advertising is to impress upon the educated public the benefits and advantages of using the thing advertised. Thus, it is an effective means of creating a new demand or at least maintaining an old one Readers of this book must be familiar with the advertisement notices that appear in all sorts of newspapers and magazines where patent madicines and other things are so highly praised as to create at once in the minds of the readers a desire to use or possess only those very things.

Trade marks, illustrations, meaningful catch words, and even appropriate 'slogans' are used in advertisements to attract and sustain the attention of customers

For different classes of customers, and for different localities, different mediums are used for advertising *e g*, wall posters, hand bills, newspapers, magazines, 'come and go' coloured electric lights, etc

Advertisement has now become an intricate science and it is not possible nor necessary to discuss all its aspects here It must be said, however, that although demand for all sorts of goods can be created by means of bogus advertising, it is ultimately really genuine articles the demand for which lasts unshaken So,

honest and genuine advertisinh is beneficial for both the buyer and the seller and it alone can improve the trade of a *country*. *and its business relations* with other countries

Mail Orders and the 'Follow-up' system—In the Mail Order plan *goods are sold through the medium* of the Post Office on the V P system A list of addresses of likely buyers is prepared and catalogues and booklets describing the merits and uses of the article or articles are sent to them This is *further supplemented* by advertisements in daily and other newspapers

This mail order or 'post order' business may be established as an independent one or may be a separate department of a business

The chief advantage of this system is that a man who is rather very busy or lives away from towns *and cities can make his selection of goods by studying* the catalogues and other literature This system originated in U S A and is now a common feature in nearly all countries

A further step in the Mail Order method is that once a letter has been sent to a customer or an enquiry received from him, the matter is not allowed to rest there if it results in no business Repeated appeals are addressed to him at *regular intervals* (weekly, fortnightly, monthly or even quarterly) pointing out the uses and merits of the particular goods, till either some business is secured or the would be customer's name has to be removed from the list This 'follow-up system *is based on* the *principle that* it requires several repeated impressions to fix an idea in the mind of the average person The main purpose of "follow-up" letters is to convince the addressee that the article in question is itself good and that he will be *wiser to* have it

8. **Samples, Trial Uses, etc.**—Samples are frequently enclosed in order to enable the prospective buyer to make tests for himself Soaps, face-creams, tooth pastes, tonic medicines, etc, are generally sent in this way Pieces of cloth are glued to letters to show the quality and design of the cloth.

In the case of costly books, gramophones, radio-receivers, etc, the general practice is to make an offer of use and trial within a stated period of a week or so Trial use is a very important form of *conviction, because it shows that the seller does not* overstate the merits of his own goods.

Again, sometimes the seller gives a *guarantee* that what he sells is exactly as represented, and that "*Money back if not satisfied.*" For watches and clocks the form of the guarantee usually is that they will give good service for stated number of years without requiring any repairs in the ordinary course If defects be discovered in the meantime the seller promises to take back the article and set it right or replace it with a good one.

Test Questions

CHAPTER XIX

Commercial Terms

Generally those terms that have already been explained in the text have not been included here

Acceptance Supra Protest—When a Bill of Exchange, *after being protested*, is accepted, by a person (who is not already a party to the Bill) *to save the credit of any person liable upon it*, it is known as '*acceptance supra* (that is, after) *protest*'

Ad Valorem means 'according to value," and applies to Stamp Duty on Bills, and also to customs Duties.

Advance means payment of part of money as price of goods contracted to be purchased, *e g*, '20% advance with order'

Advice is a written message giving information *that goods have been forwarded*, or *Bill drawn*, or it may direct a Bank to honour a cheque.

Assignment—A *transfer of property or debt by* one person to another, by means of a deed

Audit means checking of Books of Accounts by qualified persons (called Auditors) to discover any errors or frauds

Average Due Date—A date found by arithmetical calculation on which a single payment can be made (without loss to any party) instead of several payments due on different dates

Balance of Trade means *the difference between the imports and exports of a country* It is said to be '*favourable*' when the exports exceed the imports

Balance Sheet is a statement of the Assets and Liabilities of a business, and is prepared on a particular date, usually the end of the year, to show the exact financial position of the business

Bank Note is a Promissory Note issued by a Bank, payable on demand The Bank of England issues such Notes In India no Bank has the right of issuing them except the Reserve Bank Government Promissory Notes here serve the same purpose

Bank Rate is the minimum rate at which the Bank of England discounts good Bills of Exchange, or grants short loans

Bankrupt is a person who is unable to pay off all his *creditors in full*

Barter means the interchange of goods or services without the use of money

Bill of Sale—It is a security given for a debt It gives the holder the power to sell the goods named therein

Bonded Goods are those on which Customs Duty has to be paid They are stored in '*Bonded Ware houses* till the payment of such duty.

Bounty *means the monetary help given by a* Government to encourage the production of some commodity or article.

Bullion—Gold or Silver in un coined form

By-product—A commodity made during the process of producing the main article or commodity, *e g*, oilcakes in the pressing of oil

Carat—The $\frac{1}{24}$ part of an ounce it denotes the fineness of gold, *e g*, '14 carat gold' means fourteen parts pure gold and ten parts alloy.

Carrier—In general it means any person firm or company that does the work of carrying goods of other people, on hire

Charter Party—*It is a contract whereby a merchant* can hire whole of a ship It contains the terms and conditions applicable to the mutual obligations and responsibilities of the shipowner and the shipper.

Copy-right is the exclusive right enjoyed by a publisher to print and publish books specially prepared for him by authors

Crate is a case made of strips of wood, and is used for packing cycles or other small parts of machinery

Currency *means the gold* and silver coins, Notes, and other circulating media of a country Gold is the standard currency of most civilised countries, and is the basis of all payments, home or foreign. Indian currency consists of silver Rupees, Copper coins, and Government Notes

Customs Duty—The charge or tax levied by Government on the import or export of certain goods

Cum Dividend—With the right to receive the dividend due

Credit—(1) Period allowed for the payment of the price of goods purchased. (2) Good reputation of *solvency and honesty in business*

Dealers—Merchants, Wholesale or Retail

Decode—To translate the code words of a telegram into ordinary language

Demand Draft (D/D.) is a Bill of Exchange payable on demand Hundis and Promissory Notes are also drawn payable on demand. They require no 'days of grace'

Demurrage—A charge made, at a certain rate per day, by Railway and Shipping Companies (1) if goods are not removed within a fixed period, (2) if the wagons, barges or ships are detained beyond a certain agreed time

Earnest is the sum advanced by a buyer of goods in order to bind the seller to fulfil the terms of his *agreement*

E. E or E. & O. E (Errors Excepted or Errors and Omissions Excepted) are often written at the foot of Invoices, Debit and Credit Notes, and Statements of

Account The sense is that the sender of these documents reserves the right to correct any mistakes that may be discovered later on But now-a-days their use is being regarded with disfavour, since they denote the habit of slovenliness.

Entrepot—An intermediate foreign port for receiving temporarily the goods which are being shipped to another place

Excise is a tax imposed by the Government of a country on the manufacture and use of certain selected articles, for example, Salt and Opium Excises in India.

Ex-Dividend—Without any right to claim dividend which has just been declared.

Firm means two or more persons united in partnerships for the purpose of trading

Forgery is the act of fraudulently making or changing the writing, the signature, or the seal, on a document, in such a way as to harm the rights of another person

Garnishee Order is an order served by the court on persons and Banks warning them not to part with money which they owe to an adjudged debtor.

Godown—A warehouse where goods are stored by big manufacturers and wholesale merchants

Gross—(1) A set of twelve dozens. (2) The amount before any deductions are allowed on it.

House—It is used in the same sense as the term 'Firm.'

To honour a bill of exchange means to pay it when due.

Income-Tax is a payment to Government, at a certain rate, on one's income during a year, when that income reaches or exceeds a fixed limit.

Insolvent is a person who is unable to satisfy all his creditors in full, that is, unable to pay 16 annas

in the rupee He can only pay a *composit on of* so many annas in the rupee to settle the whole of his debt

Solvent means the opposite of the above

Insurance is a contract whereby a person agrees to make good the loss of life or property insured in lieu *of a premium (which see below) It may* be Life Assurance Fire Insurance or Marine Insurance

Intermediary is an agent who brings buyers and sellers together for transacting business He charges a commission for his service

Kites are Accommodation or fictitious Bills of *Exchange*

Leakage is an allowance *granted to* importers of wine or oil for the waste and damage which is likely to result

Lease is a document setting forth the conditions of a contract for letting lands or buildings for a term *of years in return for an annual rent*

Legacy is a gift made by will of one s personal property or belongings

Letter of Credit is a letter granted by a Banker or by a merchant to a person whereby he is enabled to get money, within a certain amount from the Banker *or merchant named in the letter*

When the letter bears names of several bankers or merchants it is termed a *Circular Letter of Credit*

Lien is the legal right *to hold a person s property* until payment of a debt is received

Locus sigilli—The place of putting a seal marked with a circle on a printed document

Long Bills are those Bills of Exchange which are drawn for comparatively a longer period *Short Bills are those drawn for very* short period

Marked Cheque *is one* which has been initialled by the banker upon whom it is drawn signifying that it is in order and will be paid when presented next

Merchant is a wholesale dealer or one who trades on a large scale with foreign countries.

Middleman is an intermediary or agent who acts between a buyer and a seller and makes his own profit out of their transaction.

Mortgage is the conditional transfer of land or other valuable property as security for a loan. The document containing the terms of the transfer is called the *mortgage deed.* The person who mortgages his property is known as the *mortgagor* and the one to whom it is transferred, the *mortgagee.*

Negotiable Instruments—Cheques, Bills of Exchange, Promissory Notes and Hundis are called as such, because when negotiated or passed on they confer the same rights and obligations on the receiver. They are regulated by the 'Negotiable Instruments Act.'

Notary Public is a specially authorised person, usually a *High Court Vakil,* who attests, copies, or translates certain documents; and who presents dishonoured Bills of Exchange, and protests and notes as to their non-acceptance or non-payment. He is appointed by the Governor General in India.

Overdraft.—When a Banker allows a customer to withdraw money from his account, over and above the balance to his credit, it is said to be an *overdraft.*

Patent is a sole right granted by the Government of a country entitling the *patentee* to make and use his *invention for a certain number of years,* usually fourteen. The patentee has to pay an annual fee and he is protected against imitation of his patent by any unauthorised person.

Power of Attorney—It is a formal document by which one person is legally authorised to act for another and to sign papers on behalf of that other person. He is then said to act *'per procurationem.'*

Premium is the periodical payment, (monthly, quarterly, half-yearly, or yearly) made by the *insured* to the party insuring life, goods or property.

Proxy is a person who is authorised by another to attend meetings of societies, associations, or business companies, and vote for the latter

Quorum is the minimum number of persons who must be necessarily present at a meeting for conducting the business in a rightful manner This number is always fixed in the constitution of a body or society.

Rebate is an allowance made by a banker or other person when an acceptor meets a Bill of Exchange before it is due It is so to say interest for the period for which the Bill would have still to run.

Remittance is a sum of money sent or remitted by one person to another It may take the form of coins, Notes, Cheques, Bills, or even Stamps and Money *Orders or Postal Orders.*

Retailer is one who sells goods in small quantities to the general public and is usually known as a tradesman or shop-keeper.

Sans frais—Sometimes the collecting banker is instructed not to incur any expense for *noting* and *protesting* of a Bill, when the words "*Sans frais*" are written on the Bill

Statement is an account sent out periodically (usually monthly) to debtors *It shows the various amounts of goods purchased, together with any cash paid or allowance made*, and the net balance due

Sterling is a special term used to denote English *£ s d and paper currency*

Stock in-trade means the stock of goods in the shop or godown of a merchant and ready for sale.

Stoppage in Transit—This is the right of stopping goods, while in course of being carried, by an unpaid seller.

Telegraphic Transfer (T/T)—This is a method of paying money in a foreign country by sending a cablegram The necessary amount at the *current rate of* exchange is deposited with a Bank and the Banker

sends a cable with necessary particulars to his foreign branch or correspondent.

Trade Bill is a Bill of exchange drawn in connection with actual trade transactions. It is just the opposite of an *Accommodation Bill*

Turnover is the amount of total sales affected during a certain period, usually a year.

Ullage means the difference between the full capacity and the actual contents of a cask.

Wholesaler is one who buys large quantities of goods and sells them to other merchants for export, or to retailers for home sale

Business Abbreviations

Ctge	Cartage
Cwt	Hundredweight
d	Pence
D/A	Deposit Account
	Document against Acceptance
D/d	Days after date
D/D	Demand Draft
Dept	Department
Dft	Draft
Dis	Discount
Div	Dividend
D/N	Debit Note
D/O	Delivery Order
do	ditto (the same)
Dol	Dollar
Doz	Dozen
D/P	Documents against payment
Dr	Debtor Doctor
D/R	Deposit Receipt
D/s	Days after sight
D/W	Dock Warrant
D/y or Dely	Delivery
E	East
E C	East Central
E E	Errors excepted
E & O E	Errors and omissions excepted
e g	*Exempli gratia* (for example)
Encl	Enclosure
etc	et cetera (and so on)
ex	Out without
Fcs	Francs
F A S	Free alongside ship
F'cp	Foolscap
FO	Folio
F O B	Free on Board
F O R	Free on Rail
Frt	Freight
G B.	Great Britain
G G	Governor General

Govt	Government
G P O	General Post Office
hhd	Hogshead
H M C	His Majesty's Customs
h p	Horse power
hr	Hour
i e	*Id est* (that is)
in	Inches
Ins. or Insce	Insurance
Inst	*Instant* (present month)
Int	Interest
Inv	Invoice
I O U	I owe you
Jan	January
Jun or Jr	Junior
Jly	July
Km	Kilometre
Knt or Kt	Knight
£	Pound (sterling)
lb	Pound (weight)
L/C	Letter of credit
Ltd	Limited
L pool	Liverpool
m/d	months after date
memo	memorandum
min	Minute
mm	Millimetres
mks	Marks
ms	Manuscript
M O	Money Order
Mo	Month
m/s	Months after sight
N B	*Note Bene* (take note)
N P	Notary Public
No	*Numero* (Number)
N/S	Not sufficient Funds
N Y	New York
N Z	New Zealand

O/a	On account
O H M S.	On his Majesty's Service
O R.	Owner's Risk
P	Page
Pp.	Pages
P/A.	Power of Attorney
Payt. or Pmt.	Payment
Pc	Piece
Pcl	Parcel
P c	Post Card, Per cent
P/C.	Prices Current
Pd	Paid
P pro. / Per pro. / P. p.	*Per procurationem* (by proxy)
P. m	*Post meridiem* (by noon)
P. & L	Profit and Loss
P/N.	Promissory Note
P. O	Post Office ; Postal Order
P. O O	Post Office Order
Prox	*Proximo* = (Next month)
P. S	Post (Script (after writing)
P. T. O.	Please turn over
R/D	Refer to Drawer
re	In regard to ; relating to
Re.	Rupee
Recd.	Received
Rect.	Receipt
Ref	Reference
Regd.	Registered
Retd	Returned, Retired
R. P.	Reply paid
Rs.	Rupees
R. S. V. P.	Please Reply
Ry. or Rly.	Railway
S	Shilling
Sd. or Sgd	Signed
Secy	Secretary
Shipt.	Shipment
S S. or S/S	Steamship
Stg	Sterling
Str	Sterling / Steamer
Tgm.	Telegram
T/T	Telegraphic Transfer
U K	United Kingdom
Ult.	*Ultimo* (last month)
U S A.	United States of America
Vs.	Versus (against)
Via.	By way of ; copy
Viz.	*Videlicet* (Namely)
V. P. P.	Value Payable Post
Wk.	Week
Wt.	Weight
W/w	Warehouse Warrant
Xd	Ex dividend
X in.	Ex interest
Yd.	Yard
Yr	Year
Yrs.	Years, Yours

Special Signs

%	Per cent
‰	Per thousand
"	Inches
'	Feet
$	Dollar
4 to	Quarto = folded into four parts
8 vo.	Octavo = folded into eight parts
#	Numbered
§	Paragraph

High School Examination Papers

UNITED PROVINCES

1936

1 (a) Messrs Ratilal & Co, Meston Road, Cawnpore, have despacthed the following goods to Messrs Gupta Brothers, Jhansi —

130 yd Saxoney Tweed @ Rs 3 8 per yard
60 yd Navy Blue Serge @ Rs 5 8 per yard
70 yd Grey Flannel @ Rs 5 12 per yard
60 yd Black Serge @ Rs 4 12 per yard
30 yd Overcoating @ Rs 6 per yard
Packing and forwarding Rs 9 4 Trade Discount 12½ per cent v

Prepare the Inoice in proper form

(b) On receipt of the goods the consignees find that 10 yards of Grey Flannel is damaged Write a letter to the consignors, complaining of this damage

(c) Write a reply requesting the consignees to return 10 yards of damaged Grey Flannel and enclosing the necessary document to adjust the account

2 Explain *any four* of the following terms and abbreviations —

A/S, Marked Cheque, R/R Cross Referencing, V P P, Debit Note, F O R

3. What is the object of registration? Name five postal articles which require compulsory registration How far is the Post Office responsible if a registered article is lost or damaged?

4 Describe in detail the 'Vertical System' of filing letters and give its advantages over other systems

5. Suppose you have to send Rs. 350 to Bombay. Describe the various methods of remitting this amount, and state the charge in each case.

6. *Draft the following in proper form* .—

(a) A circular letter to your customer, informing them that you have added a new department to your shop, and soliciting orders.

(b) A. D. O. letter from the District Magistrate to Superintendent of Police on the likelihood of a communal riot and advising him to be fully prepared to meet the situation.

7. What is the liability of a banker in cashing a cheque in each of the following cases :—

(a) When the signature of the drawer is forged.

(b) When the endorsement on it is forged.

(c) When it is crossed and payment is made at the counter ?

8. Distinguish between the following :—

(a) A Factor and a Broker ; (b) Cash Discount and Trade Discount ; (c) General Acceptance and Qualified Acceptance ; (d) Blank Endorsement and Endorsement in Full.

9. What advantages does a trader derive from the following ?—

(a) A Bank Account ; (b) A Telephone ; (c) A Trade Mark ; (d) A Telegraphic Address

1937

[*N. B.*—Answer *six* questions, including Question *1* which is compulsory.]

1. Messrs. Ramchand and Sons, Sitapur have sold the following goods on behalf of Messrs. Sharma Brothers, of Cawnpore :—

30 Benarsi Saries @ Rs. 25 each.

150 pairs of Dhoties, No. 129, @ Rs. 2-10 each.

500 yd of Turban Silk @ Rs 1-8 per yard
200 Bed Sheets, No 320, @ Rs 1-4 each.
600 yd Long Cloth, No 710, @ as. 8 per yard

The agents incurred the following expenses in connection with the consignment :—

Railway freight, Rs 26, Cartage, Rs 4 8, Shop rent Rs 10, Insurance, Rs 3 8 Sundry expenses, Rs. 4-12 They are to get a commission of $6\frac{1}{4}\%$ on sales Prepare the A/S in the proper form, with the letter of the Agent accompanying the A/S

2 What do you understand by the card indexing system? How does it compare with other systems of indexing?

3 Distinguish between a bill of exchange and a cheque State the advantages of the use of bills of exchange in trade

4 *How will you proceed in the following circumstances* (*a*) you are touring as a travelling agent and have no definite address but wish to have your letters by post, (*b*) you have an urgent letter to post but the time of clearance is just over, (*c*) you want evidence (i) of your having posted a letter, (ii) of the addressee having received it (*d*) your letter contains valuable *documents*?

5 Explain the meaning and use of —

B/L, P/N, D O, C/P, Credit Note, F O. B, Postal Order, and Trial Balance

6 Messrs Biswas and Co, of Jhansi, want to have an agency of the Delhi Boot Factory *Draft* the necessary letter from Biswas & Co

7 Explain clearly the facilities provided by the postal department to the public for investing their money

8 Discuss the advantages of opening a bank account to a businessman Describe the procedure adopted in opening and maintaining such an account.

9 Inform Mr Shiam Lal, a candidate for the post of stenographer in the Judges' Court, Meerut, that he should present himself for interview on the 10th April, 1936, at 11 a m in the office

1938

[*N B*—Attempt *any six* questions, including Question *1*, which is compulsory]

1 Messrs Tripathi & Co, of Bombay, have sent the following goods to the Manager, Students Co operative Stores, Chandausi —

- 12 copies, Elementary Book keeping, by S Sohanlal @ Rs 1-12 a copy,
- 20 copies, Modern Business Practice, by R Chatterji, @ Rs. 2 4 a copy,
- 500 Exercise books, @ As 2 per book,
- 100 Map Drawing books, @ as. 4 per book,
- 15 Model Exercises in Shorthand, @ As 12 a copy,

Packing and forwarding, Rs 7 8 Discount 15%

Prepare the Invoice in proper form, and write a covering letter stating that the 'Economics Made Easy, by Mathur, is out of stock, and that the R/R is sent per V P P according to instructions

2 The Headmaster of the Modern School, Lucknow, applies to the Director of Public Instruction, U P, through the Inspector of Schools, for permission to open Commerce classes Draft the necessary letter.

3 Describe the procedure in sending goods by rail Under what conditions is it advantageous to send a parcel by post rather than by rail?

4 What system of filing would you recommend for a big business office? Describe the system, and give reasons for your choice

5. Mr Jaipal purchases from Meherally & Co goods worth Rs. 750, on the 10th of January, 1938, on two months' credit Draw a B/E to settle this transaction.

6 Explain the meaning and use of :—
Debit Note, B/L I O U, Poste restante, L/C

7 *Mention the various methods of* duplicating letters, and describe any one of them in detail

8 *Compare the different ways of sending money from one place to another*

9 *Rahman & Co have received a fresh consignment of silk goods of new designs and patterns* Write a circular letter on their behalf to their customers soliciting business

1939

1 Messrs Ram Gopal and Sons of Bareilly, have sold the following goods on behalf of Messrs Mehta & Co, Delhi —

840 yards of Shirting No 140 @ 5 as per yard,

225 yards of Long Cloth No 61 @ 7as per yard,

150 pairs of Dhotis No 55 @ Rs 2/8/ per pair,

125 *Bedsheets No* 74 @ Rs 1/8/- each

48 Blankets *No* 14 @ Rs 7/8/ each

The agents have incurred the following expenses Railway Freight Rs 16 Cartage, Rs 3/4/-, Shop Rent, Rs 7 Insurance, Rs 4/8/ and Sundry Expenses, Rs 5/4/- They charge commission at 6¼%. The net proceeds are sent by a crossed cheque

Prepare the A/S in the proper form and draw up the cheque in favour of Messrs Mehta & Co

2 Describe any good system of indexing with which you are familiar and explain its advantages

3 A firm in Allahabad orders certain goods from Bombay Mention the documents which will be used in connection with the transaction up to and including the settlement of accounts and briefly explain the use of each.

4 Explain the meaning and use of the following D O E & O E *pro forma* invoice V P P and f o r

5 What advantages does a trader derive from (a) Air Mail Service (b) Telephone, (c) Telegraphic Codes (d) Trade Directory ?

6 Explain the difference between—

(a) A Factor and a Broker, (b) General acceptance and Qualified acceptance (c) Firm offer and Subject offer, and (d) Blank endorsement and Special endorsement.

7 Draft the following letters in proper form —

(a) A letter to the Registrar, Agra University, applying for the post of a clerk, giving your qualifications, age, and experience

(b) A letter in reply to an enquiry about the prices of certain goods you deal in giving the prices and terms on which you are willing to supply the goods

8 Mention four important labour saving devices generally used in business offices, and give a brief description of each

9 (a) *Under what circumstances is a cheque dishonoured ?*

(b) What services does a bank render to a businessman ?

1940

1 The Popular Woollen Mill Co, Ltd, Ahmedabad, has sold the following goods to Messrs Bal Krishna & Sons, Agra, and has drawn on them a 90 d/s bill for the payment :—

147 Superior Blankets @ Rs 11-4 each
94 White Sweaters @ Rs 7 8 each
115 Coloured Jerseys @ Rs 3 2 each
456 lb. Fine Knitting Wool @ Rs 1-12 per lb

Buyers are allowed 6¼% trade discount and 2½% for prompt payment The expenses in respect of these goods were —

Packing Rs 8 Cartage Rs 5 and Freight Rs 25

You are required to prepare the Invoice and the Bill of Exchange in proper form

2 Describe briefly the procedure of maintaining *a record of inward and outward correspondence* in a big business office

3 Explain the meaning and use of the following : —

B/L, sans recours Allonge and Special Crossing

4 Describe a suitable system of indexing and filing correspondence for a big business office

5 What are the different methods of despatching goods by rail ? Mention the important documents that are used in this connection

6 Suppose you have to send Rs 500 to Calcutta, What are the different ways by which it can be done ? Describe fully the cheapest method

7. Condense the following into a telegraphic message not exceeding 12 words, including the address —

From Sunder Dass & Sons, Chandausi, Agents, to Gopal Bros, Bombay

(Tele Add 'Wheat' Chandausi)
(Tele Add.: 'Gopal' Bombay)

'The present price of wheat is Rs 3 per maund It is falling rapidly A fall of annas four is feared to-day Kindly permit us to sell'

Also explain briefly the procedure of converting the above message into a cypher telegram

8 Write a complaint from Govind Ram to the Post Master, Lucknow, that a registered cover duly posted to his address has not reached his hands

9 Write a letter from The Indian Engineering Co, Ltd., Bombay, to Dilawar Khan & Co., Lahore offering agency for the sale of a patent fire-extinguisher and stating terms

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Rajputana Board.

1936

1 What is meant by crossing? State the various methods of crossing a cheque, explaining the effect in each case

2 (a) What are the chief characteristics of a good business letter?

(b) Write a complete letter in reply to an enquiry regarding the means, business integrity, and general reputation of a merchant whose circumstances are well known to you

Or,

(a) What is a D O Letter? Under what circumstances are such letters used?

(b) The authorities of a college desire to build a Hall The cost is estimated to come to Rs 20,000 Draft a letter to the proper Government Official, applying for a grant of one half of the cost

3 Mention the different methods of multiplying commercial papers, giving the special advantages of each

4. What system of filing and indexing of letters would you introduce in a business office accustomed to heavy *correspondence* ? *Discuss fully* the system you recommend

5 What is a Railway Receipt ? How can a consignee take delivery of the goods from the Railway authorities if the R/R is lost ?

6 Write short explanatory notes on any four of the following terms Holder in due course , del credere agent , Cypher Code Firm Offer , Qualified acceptance , Broker.

7 Prepare an account sales from the following particulars 200 bags of chillies received per goods *train* S I R and *sold by* V K Sami & Co , Coimbatore —

1930

March 5 Paid railway freight Rs 115 cartage, Rs 15

„ 7 Sold to S Velan & Sons 70 bags at Rs 10 each

„ *10 Sold to P Hassan & Co , 50 bags at Rs 9 each*

„ 20 *Sold for cash* 20 bags at Rs 10 *each*

„ 25 Sold to Surajmal 60 bags at *Rs* 10 each

Commission at $2\frac{1}{2}$ per cent , del credere at $2\frac{1}{2}$ *per cent*

8 Write an application to Messrs Ramaswami & Co , Ajmer, offering your services as a book keeper, stating your age, qualifications, and salary required

9 State what is done in the following circumstances :—

(*a*) At one copy per head, a *number of identical telegrams are to be sent to* different persons residing in the same town ,

(*b*) A letter is to be posted urgently, but the Post Office clearance time is just over (*c*) A postal acknowledgment is to be obtained that servant with whom letters are sent has actually posted them (*d*) A letter already posted is to be recalled before it reaches the addressee

1937

Note—Attempt six questions only Question 10 being compulsory

1 How is the record of outward letters kept? Name and explain the different ways of copying letters

2 Write all you know about a railway receipt

3 Ram Das & Co, Meerut, placed an order with Krishna Chandra & Co Ltd, Bombay, for 1,000 pairs of Swadeshi Dhotis at Rs 2 per pair, subject to 5% trade discount

The sellers despatched the goods by passenger train and incurred the following expenses —

	Rs
Packing	5
Cartage	2
Sundries	3

You are required to prepare an invoice from the above particulars

4 Condense the following into telegrams not exceeding twelve words each —

(*a*) I was not able to keep the appointment to-day but will meet you to morrow at 12 noon and will bring samples with me

(*b*) The goods which you ordered are not in stock, but we hope to supply them in a day or two

5 Explain the following terms and abbreviations —

(*a*) E & O E	(*d*) 'Pro Forma Invoice
(*b*) O R	(*e*) Accommodation Bill.
(*c*) Certificate of Posting	(*f*) C W O

6 (*a*) What is a Postal Savings Bank?

(b) Describe the procedure of withdrawing money from a Postal Savings Bank?

7 When can a Banker rightly dishonour a cheque? What words are used to indicate this, and what is the sense of each?

8 What is 'acceptance' of a Bill of Exchange? Give its kinds together with illustrative examples

9. What is a Foreign Bill and how does it differ from an Inland Bill?

10 (a) What is the difference between an Official letter and a Demi Official letter?

(b) Reply to the following advertisement appearing in the '*Tribune*' of the 13th March, 1937 —

'Wanted a Typist for our office Must be at least a Matriculate Preference will be given to one knowing *Book-keeping and Hindi*

Apply to the Manager, Ram Krishna Stores, Lucknow, *stating the minimum salary acceptable*

Or,

(a) Name and explain all the parts of a business letter

(b) A partner, Ramchandra, of the firm of 'Govind Ram & Bros, Fyzabad, retires and withdraws his capital *amounting to Rs 3,000 on the 1st March, 1937* On the 3rd March, 1937 Keshava Deva, the Manager of the firm, is admitted as a new partner, who contributes Rs 4,000 as his capital

Write a circular letter *from* the firm to its customers informing them of these changes

1938

Note —Attempt six questions only Question 10 is compulsory

1 Mention the advantages of preserving Business Correspondence

2 (a) What is an Index? Name its kinds

(b) From the following particulars prepare a simple Index —

Messrs Bala Prasad & Co	1, 8, 13
Hafiz Kareem Bux	9, 16 36
Messrs T Smith & Bros	2, 5, 7, 20
Pandit Ram Krishna	3, 4, 6, 10
Messrs Murray & Co, Ltd	11, 12, 30
Messrs Jhabwala & Sons	14, 28, 35
Lala Chunni Lal Gupta	40, 48, 51
Thakur Devi Singh	80, 90, 98
Messrs Kewal Ram & Co	79, 85
Mr Yogendra Nath	99, 105

3 What is a Postage Book and what is its usefulness? Draw one as an example

4 (a) What do you understand by the Imprest system of *Petty Cash Book*?

(b) Prepare a Petty Cash Book from imaginary items

5 (a) Describe the procedure of opening a Current Account in a bank

(b) Name and explain all kinds of accounts that you can open in a bank

6 Define a Bill of Exchange and distinguish it from a Cheque

7 Explain the following terms and abbreviations —

(a) Sterling Money Order (b) Payee (c) A/S (d) Reserve Price (e) F O R (f) R/D

8 Name all the points of difference between a Broker and a Factor

9 Prepare an Account Sales from the following particulars :—

On 15th October 1909, Delmaine Bros., of London, shipped to Donnison & Sons of Port Elizabeth, 60 cases of mixed Sheffield goods These goods were invoiced *pro forma* at £32-10s per case The payments made by *Donnison & Sons were—storage £16 12s.,*

Landing Charges £6 10s, Insurance £2 11s and Sundry Expenses £1 On the 15th December Donnison & Sons sold all the cases at £50 per case On the 16th December they remit the money due from them to Delmaine Bros by a Cheque, deducting their commission at 2% on sale price

10 (a) Give the requisites of a good business letter

Explain the following terms and abbreviations :—

(i) P S (ii) Enclosures (iii) Per Pro. (iv) Complimentary close

(b) The Authorities of a Govt -aided College desire to build a Hostel to accommodate 60 students Plans etc are ready and the cost is estimated to come to about Rs 50,000

Draft a letter to the Director of Public Instruction or some other proper educational authority applying for a grant of one-half of the cost

Or.

You are a wholesale cloth dealer Messrs Ramjeelal & Sons, cloth dealers, Kishangarh, desire to open a credit account with you and assure you that they would purchase cloth worth about Rs 5,000 a year and give the name of the Imperial Bank of India, Jaipur, as reference

Write a letter to the Agent, Imperial Bank of India, Jaipur, enquiring about the financial condition and reputation of Messrs Ramjeelal & Sons

1939

1. What points should be settled when you place an order for the purchase of goods ?

2. In what cases is it compulsory to register an article to be sent by post ? If a registered article is lost, is the Post Office responsible for it ?

3. Explain a code and tell how a cipher message is sent and deciphered

4 What is a Statement of Account?

From the following particulars, prepare a statement of account to be rendered by Messrs Krishna Gopal & Co, Cloth Dealers, Cawnpore, to Messrs. Ramjeelal & Sons, Meerut —

1938			Rs
March	1	Owing by Ramjeelal & Sons	500
,	8	Sold them goods	100
,	10	Goods returned by them	20
,,	15	Received from them	320
,	20	Sold them goods	150
,,	29	Received a cheque from them	100

5 Explain the following terms and abbreviations —

(a) Bill of Lading (b) V P. P.
(c) Credit Note (d) D L O
(e) Advice (f) F. O R destination

6 Explain Card Indexing, and point out its superiority over other methods of indexing

7 Define a cheque, and distinguish between (a) an Order Cheque and a Bearer Cheque, and (b) a Crossed Cheque and an Open Cheque

8 What is an endorsement on a Negotiable Instrument? Name and explain two kinds of endorsement

9 What are the points of difference between a Bill of Exchange and a Promissory Note?

10 *Either*

Write a letter placing an order for certain goods

Or,

Write a letter to the Secretary, Board of High School and Intermediate Education, U P, as from the Secretary, D S High School, Almora, asking for permission to open Commerce as one of the optional subjects in his school

1940

1 The acceptance of a bill of exchange may be either 'general' or 'qualified' Explain these terms, and give two examples of a 'qualified acceptance'.

2 What is meant by 'Crossing' a cheque, and why is the practice resorted to ?

A person at Cawnpore, having no banking a/c, receives a crossed cheque on the Imperial Bank of India, Agra Branch How should he get the cheque cashed ?

3. What is 'filing' ? Why is it necessary ? State the principal qualities of a good and an up-to date file

4 What are the advantages of a telephone to a business man ? Explain the circumstances in which a telephone message will be preferable to a telegram

5 Explain *any four* of the following —
Express delivery, B/L, Tare, Broker, Franking, *Pro forma* Invoice, Cypher Code, Holder in due course

6 What are the principal methods of despatching goods ? Describe fully the procedure to be adopted when sending goods by passenger train

7. In what cases is it compulsory to register an article to be sent by post ? If a registered article is lost, is the post Office responsible for it ?

8. Write an imaginary official letter.

9. Bal Krishna & Sons, Ajmer, are acting as the *del credere* Agents of the Popular Woollen Mills Co, Ltd, Ahmedabad, on the following terms —
Commission 5% and $1\frac{1}{2}$%, Monthly A/S, together with a cheque for the amount due

In January, 1940, they sold the following goods on behalf of their Principal —

147 Superior Blankets	@ Rs 11 4as each.
95 White Sweaters	@ Rs 7 8 as each

115 Coloured Jerseys @ Rs 3 2 as each

456 lb Fine Knitting Wool @ Re 1 12as per lb

Their disbursements in respect of these goods were: freight and cartage, Rs 45 shop rent, Rs 23, sundry expenses, Rs 25

You are required to—

(a) prepare the A S in proper form and

(b) draft the necessary accompanying letter from the Agents

Delhi School Board—1937

[*N.B* —Credit will be given for brief and to the point answers]

I. (a) You receive a consignment of X'mas *novelties, crackers, and other sundry articles for the* X'mas season from London. Name the various docu *ments which you would receive from the consignor* to enable you to take delivery of the consignment at the port *What formalities you would be required* to undergo for the delivery of the goods in your godown

(b) Acknowledge the receipt of the above consignment to the consignor expressing poor satisfaction with the quality of the goods

II Describe the various methods by which you can effect the payment of the above consignment to your consignors in London

Give specimen of one of the most *convenient* instruments by which you would prefer to remit the money

III. You wish to open a Savings Bank account with the Punjab National Bank, Ltd Delhi. Describe the various formalities which you would be asked to undergo by the manager before opening the account Also name the paper and documents which

would be handed over to you after your account has been opened in the Bank

What are the restrictions, if any, for with-drawing money from the Savings Bank account ?

IV Give the suitable 'Salutation' and 'Superscriptions' for any of the 4 (four) following letters —

(a) To the advertisement manager of a local paper to insert an advertisement in his paper

(b) To Mesdames Sheela and Leila, Hair-dressers

(c) To a Maharaja of a state

(d) To the principal of a college for seeking your admission

(e) To His Excellency the Viceroy of India.

(f) To the wife of a knight, requesting her for donation

V Explain the following to show that you understand them —

(a) Debenture	(e) Indent
(b) Chambers of Commerce	(f) C O D
(c) Factor	(g) ‰
(d) Broker	(h) O/D

VI Six ordinary telegrams of the same subject are to be sent by you each not exceeding 8 words (the message being five and address three), to be delivered in Calcutta Calculate the total cost you will be asked to pay for the 6 telegrams

What formalities if any, are provided by the postal authorities for transmitting different articles including Samples, Registered parcels, etc, to Great Britain ?

VII Distinguish between a 'Joint' and a 'Joint and Several' promissory Note

Draw up a Promissory Note with the following particulars —

Term —Three months after date

Payee —Messrs Talk and Walk
Amount —Rs 800
Makers —Sure Success and Co
Date —3rd November, 1936

1938

1 Give the main parts into which a business letter is divided

Your father who has recently taken you in his business asks you to draft a circular letter required to be sent to his clients about the special reduction in prices during the X'mas week. Draft this circular letter setting out your subject in paragraphs

2 Give the various systems of filing that you know and describe the one which you think to be very popular and mostly used in business firms

3 How far do you think the man power is being replaced by mechine power in the business world Describe the most effective mechanical device used in big retail stores, to have a check on cash sales

4 In what way the Bill of Lading differs from a Railway Receipt ? Describe the essential features of a Bill of Lading and the purposes served by it

5 (a) What facilities are afforded by the Indian Posts and Telegraphs department to avoid waste of time in sending and receiving telegrams ?

(b) Under what conditions can you recall a letter from the post office ?

(c) What would be the cost of a sterling M O for £22 ?

6 (a) A friend of yours having Rs 500 with him asks your advice to invest this money in such a way that small amounts when needed by him be made available to him without any loss of interest on the balance What investment you would recommend him to suit his requirements ?

(b) Give a specimen of a fixed deposit receipt with a counterfoil, filling in your own details

7. Explain the following to show that you understand them —

(a) Del credere Agent
(b) A letter of Hypothecation
(c) Cross reference
(d) Paying in the slip
(e) Certificate of posting
(f) Vide
(g) Franco
(h) D/P
(i) X D
(j) C O D

1939

1. Apply for the following post —

Wanted a capable honest and hardworking Assistant having knowledge of Accounts, Office-Routine and correspondence. Apply, stating age, qualifications and experience with testimonials and references, to Box. No 1939 C/O 'Hindustan Times' New Delhi.

Or

On receiving a consignment of Hosiery from Punjab Hosiery Factory, Ludhiana, you find the following defects and irregularities —

(A) The goods are not according to the samples approved by you

(b) Some of the boxes contain less than 6 pairs of socks

(c) Some of the boxes are found damaged

(d) The prices and other charges are more than those settled with you

(e) The goods have reached you very late

Write a letter of complaint to the above firm, refusing to accept the goods and claiming damages

2 Describe briefly the methods for remitting the following amount —

(a) £ 500 to a firm in London

(b) $ 600 to a firm in New York.

(c) Rs 700 to a firm in Madras

(*d*) Rs 400 to your brother, living in a village Which of the methods suggested by you would be safe and economical ?

Describe briefly the functions of either a Bank or a Post Office

3 Is the following cheque in order ? If not, point out the defects

The Bank of Delhi Limited
No 98765
Delhi 1st March, 1939
Pay to Ram Lal or Gopi Nath or order the sum of Rupees Seven hundred only against delivery of 3 bales of Cotton
By order of the Board,
(Sd) Kishan Narain, Manager,
Rs 700 5 6 National Trading Co Ltd.

Will the Bank honour the cheque if it is presented on 25th February, 1939 or 1st October, 1939 ?

Or,

(*a*) Send a Telegraphic order to Messrs Meston & Co , for 1 Electric dynamo of 1,000 Volts and ask for delivery within a fortnight.

(*b*) Send another telegram cancelling the above order as they failed to supply the dynamo within a fortnight

4 Write short notes to show the difference between any 5 of the following :—

(*a*) Ultimo and Proximo

(*b*) Ante dated and Post dated

(*c*) Telegram and Cablegram

(*d*) Advice and Invoice

(*e*) Savings Bank A/C and Current A/C

(*f*) Dividend and Bonus

(*g*) Salary and Wages

(*h*) Indemity and Insurance

5 Describe very briefly but clearly the various systems of filing letters which of these would be suitable for a (a) Banker (b) a Professor and (c) a petty trader?

6 Explain any six of the following terms —

1 Fixed Deposit Receipt
2 Paying in Slips
3 Postal Cash Certificate
4 Demand Draft
5 Bills of Lading
6 Risk Note
7 Postal Order
8 Phonogram
9 Telegraphic Address
10 Addressograph
11 Chamber of Commerce

7 Messrs Ratan & Co of Lahore send the following goods to Messrs Gopal Bros, of Delhi and draw on them a bill for the full amount of their Invoice payable 60 Days after sight

100 yds Serge @ Rs 4 per yard
30 yds Velvet @ Rs 5 per yard
20 Blankets @ Rs 7 each
50 Boxes of Goodrej Soap @ Re 0 12 0 each
5 Boxes of advertising material No value

They allow you 5 per cent Trade discount but charge Rs 8 for packing and forwarding

Prepare an Invoice a Draft for the full amount and Draft a letter to the Bank through whom the R/R is sent

1940

1 On taking delivery of a parcel of Stationery from Bombay you find half of it contains only waste paper Draft letters of complaint to the Railway Company and the suppliers claiming damages

Or,

On 20th August 1939 Messrs Ratan & Co (Telegraphic address Ratan) send an order for 3 bales of longcloth with the Textile Mills Ltd (Telegraphic address Textile) Bombay On 10th

September 1939, they wish to increase the order to 5 bales and send a wire to this effect You are required to —

(a) draft the letter placing the original order,
(b) draw a telegram, increasing the order to 5 bales,
(c) write a letter confirming the telegram

2 Explain briefly any *six* of the following —

(a) *Foreign telegram*, (b) *Press telegram*, (c) Phonogram, (d) Greetings telegram, (e) Cypher telegram, (f) Cablegram, (g) Telegraphic address, (h) Multiple address telegram

3 (a) Describe briefly Indian Telephone system, and state the rates charged in Delhi

(b) Write short notes on —

(1) Trunk telephone, (2) Particular person calls (3) Overseas telephone service

Or

How will you send an R/R of goods despatched *to Ambala in order to get prompt payment of* your money and to ensure quick delivery of the goods to your customer? Draft necessary letters or documents for this purpose

4 (a) What are the essentials of a good *business* letter?

(b) Write a letter to the Director of Government War Supply Depot, offering a regular supply of blankets of approved quality and at reasonable rates

Or

Write a *circular letter to your customers* announcing —

(a) appointment of an Expert Motor Engineer.
(b) shifting your business to better and bigger premises,

(c) securing agency of a new Make of Car,

(d) opening of a petrol pump and service station

5 Distinguish between any *four* of the following :—

(a) Cheque, draft, Hundi and Bill of Exchange,

(b) Agent, broker, factor,

(c) Holder for value, holder in due course,

(d) Fixed Deposit Receipt, Cash Certificate,

(e) Trade discount, Cash discount,

(f) Invoice, Bill, Account Sales

6 *Briefly* describe any *three* of the following —

(a) Vertical system of filing, (b) Card Index, (c) Duplicators, (d) Calculating Machine, (e) Addressograph.

Or,

Explain any *six* of the following terms —

Affidavit, Demurrage, Letter of Credit, Trade Mark, Dividend, T/T, D L. O., R M S, Power of Attorney, E & O E

7. What arrangements would you make under the following circumstances :—

(a) You are touring as a travelling Agent and have no definite address but wish to have your letters delivered to you, wherever you are

(b) You have an urgent letter to post but the last clearing time is over

(c) You have to produce evidence (1) of your having posted a letter, (2) of the delivery of your letter to the addressee

(d) You want your letter to be delivered to the addressee immediately on its arrival at his city post office

Benares Hindu University
1938

[*N B* — Question *1* and *8* are compulsory. Of the rest attempt *any four*.]

1 What is an Invoice?

Pyare Lal & Co, Benares placed an order with Badri Parsad & Co Ltd Bombay, for 2,000 pairs of Swadeshi Dhoties at Rs 3 per pair subject to 5% trade discount and $1\frac{1}{2}$% on cash payment within 15 days

The sellers despatched the goods by goods train and incurred the following expenses —

	Rs
Packing	15
Cartage	12
Other Expenses	15

You are required to prepare an Invoice from the above particulars

2 How is the record of outward letters kept? Name and explain any one method of copying letters

3 (*a*) What is the use of registering an article? What things must necessarily be registered?

(*b*) Does the Post Office pay compensation in all cases for damage or loss to insured articles? Point out the cases when this is not possible

4 (*a*) What is a telegraphic code? What purpose does it serve?

(*b*) What is a Cipher Telegram? Explain clearly by an example.

5 What do you understand by a crossed cheque? Illustrate the two forms of crossing and their effect.

6 Define a Bank. Name the kinds of accounts that can be opened at a Bank. What difference do you note in a Current Account and a Deposit Account?

7. What does each of the following terms denote?—

(a) Loco (b) f o b, (c) c i f and (d) In Bond

8 A partner Ram Lal of the firm of 'Ram Lal Magan Lal, Benares retires from the firm, and withdraws his capital amounting to Rs 5 000 on the 1st January, 1938 On the same date, Keshav Dev, the manager of the firm, is admitted as a new partner, who contributes Rs. 6,000 as his capital

Write a circular letter from the firm to its customers, informing them of these changes

Or

As Registrar of the Allahabad High Court, inform Mr Shiam Lal that this application for the post of a typist in the High Court cannot be entertained as there is no vacancy at present His name however, has been registered

1939

1 Define a Bill of Exchange (अंगरेज़ी हुन्डी), and distinguish (भेद निकालो) it from a Cheque Draw a Bill of Exchange on *Messrs* Bala Prasad & Co, *Benares for* Rs 275 8as payable 60 days after sight and give its due date (सिकारे जाने की तारीख़)

2 (a) Mention the advantages (लाभ) of preserving Business Correspondence (व्यापारिक चिट्ठी पत्रों को सुरक्षित रखने के)

(b) What is an Index ? Name and explain its kinds

3 What do you understand by the Imprest system of Petty Cash Book (खुदरा खर्च रोकड़ बही) ? Prepare a Petty Cash Book from imaginary items (कल्पित रकमों से)

4 Explain the following terms (शब्दों) and abbreviations (लघुरूपों) —

(a) Not negotiable (b) AS (c) Reserved Price, (d) f o r,, and (e) R/D

5 What is a Postal Savings Bank? Describe the procedure of withdrawing money (रुपये निकालने की विधि) from a Postal Savings Bank.

6 Explain an agent, and tell his importance in trade *Name the different kinds of agents and their* respective functions (अपने २ कार्य)

7 Mention the different methods (भिन्न भिन्न तरीके) of multiplying commercial papers (व्यापारिक पत्रों की अनेक प्रतियां निकालने के)

What *method or methods of duplicating* would you adopt in the following cases?—

30 copies of a circular letter are to be sent

5 090 copies of a document are to be sent.

8. What is the difference between an Official letter and a Demi Official letter?

Write a letter from the Secretary, Federal Public Service Commission, to Mr Badri Datta Pande, M.A., informing him that he has stood third in order of merit at the last I.C.S Examination and that he should present himself for an interview before the Commissioners as 11 a m on the 25th of September, 1938 in the Commission's office at Simla.

Or,

Reply to the following advertisement appearing in the *Leader* of the 13th March 1939 —

'Wanted a Typist for our office Must be at least a Matriculate Preference will be given to one knowing Book-keeping'

Apply *to the* Manager, *Ram Krishna Stores*, Benares, stating the minimum salary acceptable

Muslim University—1939

1 As Collector, District Bulandshahr, write a letter to the Divisional Commissioner, informing him of the scarcity of rainfall and the damage done *to the kharif and rabi crops of your district.*

2 Abdul Ghani of Aligarh has purchased goods worth Rs 450-8-0 from Ram Chandra & Sons, Delhi Write a letter from the seller, to the buyer advising him of the despatch of goods and requesting him to pay the price at an early date

3 Draw up a Bill of Exchange from the following —

Drawer : Kapoor and Co , Cawnpore
Drawee : Rahmat & Co , Agra
Amount Rs 640 8 0
Term : 3 months after date

Supply other details yourself if necessary

4 What system of filing would you recommend for a large business office ? Give your reason, and explain the system clearly

5 Explain the following terms clearly - 'Cypher Telegram ', 'Post Restante', 'Certificate of Origin', 'Account Sales', and 'Copying Press

1940

1. (*a*) Owing to the outbreak of war between Germany and Great Britain there is a general rise in the prices of commodities On behalf of Mohan & Co , Bombay, you are required to inform their *arhtia* at Hapur to purchase 10,000 *maunds* of wheat at once, at the best obtainable price in the market The telegram must be in proper form

(*b*) Confirm your telegram by a letter

2 Reply to the following advertisement —

'Wanted an accounts clerk for the office of the *Director of Industries*, U P, on a salary of Rs 30 2 50 None need apply *who* has *not* passed the High School Examination with Commerce '

3 Mr D L Bhargava, of Aligarh, sends a cheque of Rs 470-8-0 to Messrs Anwar Ali & Co , Delhi, in full payment of their account You are required to draw up the cheque and the forwarding

letter *enclosing it.* Take *the necessary precautions* to ensure the safe delivery of the cheque

4. *Explain the following* .—

'Express delivery letter', 'Telegraphic money order', Cash Certificate', 'Dead Letter Office', and 'Postal order'.

5 Use the following titles and abbreviations correctly: Messrs, Capt, Khan Bahadur, I C S, I.M S, LL M, Sir, P E S., and Kunwar.

Punjab University 1937

1. Condense the following into a telegram to be sent to the Principal, Mahila Mahavidyala Girls' High School, Lahore (*telegraphic address* 'Maha vidyala') using as few words as possible but they should be enough to achieve the object the sender has in view :—

'My brother is going to England, and I am accompanying him as far as Bombay. I request the favour of your kindly granting me leave of *absence for a fortnight.*'

2 (*a*) Draft a letter to Messrs Parco & Sons, Radio Dealers, The Mall, Lahore, to send you half a dozen samples of Radio sets of different makes at their earliest convenience, giving the minimum possible *quotations*.

(*b*) Draft a letter to your landlord asking him to put the house in which you reside in a proper state of repairs, especially the roof of the verandah, and to have the whole house whitewashed and painted

3. (*a*) Draft an application in reply to an advertisement, which has appeared in the *Tribune* of the 22nd June, 1936, for the post of a Ledger Clerk in the Central Bank of India, Ltd., Nila Gumbad, Lahore

State your academic qualifications, family claims, age, state of your health and accounts experience

Or,

(*b*) What do you know of the following? Any five terms may be attempted —

Advance Agent Bargain, Circular, Clerical errors Commission Exports, Freight Merchant; Indent Interest, Mortgage, Reference, Sample, Wholesale

4 Rule a specimen page of a Correspondence Register, and enter briefly the substance of each of the following three letters —

(*a*) Murray College,
Lahore,
The 22nd June, 1936

B Das Esquire,
5, Chitranjan View
Amritsar

Dear Mr Das,

I am sorry to say that your son is not behaving properly in the college and has been very irregular in attendance I deem it my duty to bring it to your notice, so that you may take timely action in the matter He is intelligent, but requires some restraint, supervision, and guidance

Yours sincerely,
(Sd) M S Phillips,
Principal

(*b*) 5, Chitranjan View,
Amritsar, 30th June, 1936

Dear Mr Phillips,

I am very thankful to you for having drawn my attention to the unsatisfactory behaviour of my son In fact, my suspicions had been roused long ago, and I was about to address enquiries to you I am really sorry that my son should thus go astray and be a spoilt child I have given him a bit of my mind

to-day, and have stopped his allowances. I have put him under a tutor I hope he will mend his ways as he has promised to do, as will appear from his letter enclosed herewith, and I shall be obliged if you could kindly keep an eye on him and let me know if any improvement be visible. Professors and teachers are, as a matter of fact, in the place of parents and have great influence on boys.

Hoping to be excused for the trouble,

Yours sincerely,
(Sd.) B Das.

To

M. S Phillips, Esquire.
Principal, Murray College
Lahore

(c) Murray Hostel,
Lahore, 26-6-3-6

My dear father,

I confess with shame that the complaint you have received from my Principal about my irregularity is only too true I plead guilty, and can offer no excuse at all except my own folly. I ask you and my kind professors forgiveness with a sincere and repentant heart and promise not to give you any cause of complaint in future I realize my mistake and the loss I have suffered. I shall turn over a new leaf and hope to win your approbation and the good opinion of my professors and Principal

With sincere apologies and a hundred regrets at my past folly.

I am,
Your loving son,
(Sd) Surrendar.

To

B Das, Esquire,
5, Chitranjan View,
Amritsar.

5 (a) Prepare a brief precis (in one continuous passage) of the three letters given in Question 4 above

Or,

(b) Give a clear and concise summary of the following passage —

The Dhobi washes clothes His method is very rough He beats the clothes violently against a stone or a hard wooden plank and some of them are torn away in the process His work is very hard He has to stand in cold water in winter and in summer the sun beams over his head, so that, summer or winter, he works under trying circumstances We have a good Dhobi, who does the work to our satisfaction He is regular and returns clothes which we give him for washing usually after ten days Some Dhobies are very irregular and cause inconvenience to their customers by delay

The Dhobi has a bullock or a donkey, on which he carries his bundle of clothes to the stream He never mixes up clothes of different persons After washing clothes with soap and alkali, he puts them in a large vessel of boiling water He then wrings water out of them, dries them in the sun, and afterwards irons them to remove creases The dirt being thus washed away, the clothes are bleached, and they become as good as new

1938

I (a) What do you know of the following? Any five terms may be attempted —

Advice, Bale, Bid, Broker, Call, Cancel, Case, Claim, Clients, Contract, Deed, Finance, Firm, Import, Net amount, Port

Or,

(b) Draft an application in reply to following advertisement for the post of a junior clerk —

'Wanted a young man with knowledge of English and Urdu for the Punjab Civil Secretariat. State

qualifications, age, *experience, if any*, and the minimum pay acceptable Apply to the Assistant Secretary to Government Punjab, Lahore

II. Condense the following into a telegram to be sent to Messrs Prem Prakash & Coy , 5, Chitaranjan Avenue, Calcutta, (telegraphic address Prakash) using as few words as possible, but they should be enough to achieve the object the sender has in view :—

I was very glad to find your father's name in *the New Year s Honours List* The title of Rai Bahadur conferred by the benign Government was *long overdue* Kindly *accept our hearty congratula*tions on this happy occasion, and convey them to all the members of your family '

III (a) Draft a letter to a class fellow friend of yours, asking for a loan of money, assuring him of *early refund*

Or,

(b) Draft a letter to Messrs Chiragh Din & Sons, Saddlers, Anarkali, Lahore, requesting them to make payment of the amount outstanding against them for the last nine months, promptly

IV Rule a specimen page of a Correspondence Register, and enter briefly the substance of each of the *following* three letters :—

(a) 20, Montgomery Road,
Lahore,
the 10th March, 1938

M Rashid Ahmad,
7, Mayo Road,
Lahore

My dear Rashid,

My father is going to take me for rowing on the river this evening and he wants me to ask my friends

to join us Will you come? I shall be so glad if you do I think we shall be able to muster a party of nine or ten It promises to be a delightful evening and I hope we shall have a jolly party I shall wait for you at five in the evening

Please write a line to say that you are coming

With kind regards,

I am,
Very sincerely yours,
Balbir

(b) 7 Mayo Road,
Lahore,
the 10th March, 1938

Balbir Singh, Esquire
20, Montgomery Road
Lahore

My dear Balbir,

Thanks for your kind note and the pressing invitation, but I am sorry I cannot join you this evening The fact is I must sweat for my examination

Wishing you a pleasant evening

I remain,
Yours ever,
Rashid

(c) 28, Montgomery Road,
Lahore 12 3 38

M Rashid Ahmad
7 Mayo Road Lahore

My dear Rashid

I am sorry you could not join us on the 10th instant We were a party of eight and we had a delightful time on the river

The clear water reflected the clouds like a mirror The sunset was glorious I can give you no idea how grand it looked, especially when we came to a bend in the river which gave us a view of it all through the trees

You would have enjoyed yourself greatly had you been with us Really you ought not to bore away always at these books of yours without taking any recreation You feel tired at times over your studies and I do not wonder at it Believe me, my dear fellow, the hunger and thirst and weariness our bodies feel are but gentle reminders from God who made us that *we need food and drink and recreation* I felt all the fresher for my studies after I came home.

Regretting you did not come,

I remain,
Sincerely yours,
Balbir.

V (*a*) Prepare a brief precis (in one continuous passage) of the three letters given in Question IV above

Or,

(*b*) Give a clear and concise summary of the following passage .—

From time immemorial fairs have been held in India. But every fair thus held had a trade purpose in view For instance, in Lyallpur a great Mandi is held once a year, in which Government Remount Officers come and buy horses At dusk the lights of many thousands of camps are a beautiful sight. We are greeted everywhere by smiling villagers and officers *In the morning we visit horses and camels* drawn up in a line We see noted breeders and admire their stock. The well built villagers with their picturesque head dress, appear most attractive as they

ride about We listen to stories of the past—how so and so won a gold medal for the best mare and how this happened in the good old daysa suc hond such an officer

In the afternoon there are races The soil is hard and covered with loose stones Excitement runs high and the spectators shout like mad men Last of all comes the camel race The camel is a grudging animal If he can, he will refuse to go to the post at all His rider has one rope only to control him and that is tied through his nose In the last resort all that can be done is to pull his head round hard against his shoulder So he can really run in any direction he likes and generally does so without any regard to his rider s wishes

That afternoon one camel refused to run, and, when beaten, threw himself on the ground like a child in a temper, and rubbed his nose in the dust !

Calcutta University
1937

[*N B*—Candidates are required to give their answers in their own words as far as practicable]

Group A

Answer any *four* Questions

1 Write an answer to the following advertisement –

'Wanted, a stenographer (matriculate), fast and accurate, with knowledge of filing, for a mercantile, office in Calcutta Apply, stating age, experience, and salary expected, to Box 4091, *The News of Bengal*, Calcutta

2 Assuming that you have been appointed the local agent for the sale of bread, butter, and jams of a certain factory, write a suitable circular letter to be sent to persons likely to buy from you

3 (*a*) Construct sentences illustrating the different meanings of any **two** of the following words—*bark*, *lie*, *match*, and *pound*.

(*b*) Write a telegram, **not exceeding twelve** words, including the addresses to 'Bengnews, Calcutta' (the telegraphic address of the Calcutta newspaper, *The News of Bengal*), signed 'Booknews, Lucknow' (the telegraphic address of your own shop in Lucknow for selling books and newspapers), ordering 500 copies of the anniversary issue of *The News of Bengal*, and offering to pay the price at the end of the month What would be the charges if you send it at (i) ordinary and (ii) express rates ?

4. (*a*) Make out an invoice for 1,000 bales of jute at Rs 25 per bale c. i f., the whole shipped per S S *India* by Messrs Nagarmull & Co, Calcutta, to Messrs Hessian & Co, Dundee, each bale numbered and marked

H C

Insurance effected with The Safety Co., Ltd

(*b*) Draw up the bill of exchange for the above transaction, and state what stamp will be necessary. Can you use *hurdi* paper with embossed stamps for the bill ?

5. Write a short essay on 'The Post Office and its service to Trade'

6 Explain any **four** of the following :—Code telegram, documentary bill, good will, letter of credit, letter of hypothecation, loose-leaf ledger, and promissory note

GROUP B

Answer any *two* Questions.

7. Explain the different kinds of insurance of use to business-men.

8 *What is the effect of 'crossing' a cheque?* In what different ways may this be done?

9 What are the advantages of a bill of exchange to commerce? Explain clearly what is meant by *saying that a bill of exchange is a negotiable instrument*

10 State the name of the countries in which any **four** of the following currencies are used, and their approximate values in terms of rupees :—dollar, franc, guilder, lira, mark and yen

1938

[*N B* —Candidates are required to give their Answers *in their own* words as far as practicable]

GROUP A

Answer any *four* Questions

1 *Draft a suitable advertisement for the post of* a junior assistant in a mercantile office in such a way that all necessary particulars may be obtained from the replies to be sent in by applicants

2 Write an answer to the advertisement mentioned in Question 1

3 Write a short essay on 'Banks and their services to trade'

4 Draw up a report discussing the possibilities of starting a branch office in a certain town in Bengal *assuming that you have been sent there* for inquiry by a Calcutta bank, of which you are an employee

5 Explain clearly any **four** of the following — (*a*) petty cash book (*b*) trunk lines, (*c*) reconciliation statement (*d*) *telegraphic transfer*, (*e*) *consular* invoice, (*f*) allotment letter

6 State the meanings of any **six** of the following —(*a*) C A, (*b*) C O D, (*c*) G P O (*d*) Ltd, (*e*) mm, (*f*) *nem con*, (*g*) O K, (*h*) *per pro*, (*i*) ult

Group B

Answer any two Questions

7 Describe how a current account is opened in a bank by a customer and the books supplied by the bank to him

8 Distinguish clearly between a negotiable instrument and a transferable document Give examples of each

9 What are meant by general average and 'particular average in connexion with marine insurance? Illustrate the difference with examples

10 Explain the customs formalities in connexion with imports into India

1939

Group A

Answer any *three* questions

1 Write out a short advertisement for the sale of a business giving the most essential particulars and stating how the other particulars may be obtained

2 *Draft a letter to your supplier complaining* that the goods received are not according to the sample and claiming compensation

3 Make out a cheque for Rs 503 10 a 3 p to order and cross it specially in the name of the *Indian Central Bank Ltd* State how the payee may obtain the money

4 Give specimens of the following —(*a*) a Bank paying in slip for cheques (*b*) a *Debit Note* (*c*) a Foreign Bill of Exchange in a set of two

5 State the appropriate abbreviations for the following and give their meanings —(*a*) cost insurance and freight (*b*) *errors and omissions excepted* (*c*) free from capture and seizure (*d*) free from particular average (*e*) free on rail

6 Explain briefly the meaning of any *six* of the following —(a) Actuary (b) Consular Invoice (c) Director of a Company (d) Goodwill (e) Invoice (f) Lessor (g) Letter of Credit (h) Letter of Regret, (i) Royalty (j) Stale Cheque (l) Telegraphic Transfer

GROUP B

Answer any *three* questions

7 What do you mean by a Clearing Bank? What is its importance to trade? Name any *five* Clearing Banks in Calcutta

8 Distinguish between — (a) Cumulative and non Cumulative Preference Shares (b) a Partnership and a Private Limited Company (c) *ad valorem* and specific duties

9 *What principal books are generally used in mercantile offices? What are their uses?*

10 Quote the rates for the following inland postal transactions (a) book and pattern packets, (b) express telegrams (c) insurance (d) money orders (e) ordinary telegrams (f) parcels (g) registration

11 *What do you mean by a unit of (a) sale and (b) shipment? Illustrate your answer with three examples of each from the Calcutta market*

12 Name the *countries where the following* currencies are used giving the approximate exchange rate quoted in the daily newspapers in each case — (a) dollars (b) francs (c) liras (d) marks and (e) yens

1940

GROUP A

Answer *any four* questions

1 The Calcutta Sugar Company quoted Rs 10 12as per maund for 50 maunds of white sugar to be supplied to the Calcutta Retail Stores a few days ago and sent a reminder as no order was received To that reminder draft a suitable reply from the mana

ger of the Calcutta Retail Stores, pointing out that a quotation of Rs 10 10as has been obtained from another wholesale supplier of sugar and asking if the Calcutta Sugar Company was agreeable to reducing the rate accordingly

2 (a) Draft a telegram from the Calcutta Jute Bag Co Ltd to the Karachi Wheat Export Co, Ltd, informing that on account of a labour strike only 1,500 wheat bags out of a total order of 3,000 have been despatched to-day per goods train and the remainder cannot be delivered before July 7 next [Code word for the Calcutta Jute Bag Co, Ltd is JOOT, and that for the Karachi Wheat Export Co, Ltd is WEET]

(b) State the charges for the above telegram

3 A book selling and publishing business is for sale as a going concern Draft a suitable advertisement, giving some of the necessary particular, and stating how the other particulars may be obtained.

4 Describe briefly at least *six* of the services rendered by a bank to its customers

5 Write a short essay on 'Salesmanship'

6 Explain briefly the meaning of *any six* of the following —

(a) allotment letter, (b) bill of lading (c) book debts, (d) B C T T rate of exchange, (e) drawee, (f) journal, (g) loose leaf ledger, (h) treasury bill, (i) trunk call

7 (a) Give a *complete* specimen of—

(i) an inland bill of exchange,

(ii) a foreign bill of exchange in a set of three

(b) State in each case the stamp necessary, and also whether it is embossed or adhesive

8 Explain clearly the meaning of *any eight* of the following abbreviations —

(a) C A (b) C O D., (c) F & O E, (d) f o r., (e) G P.O, (f) Ltd, (g) mm, (h) *nem con*, (i) O K, (j) R A., (l) ult

GROUP B

Answer *any two* questions

9 Distinguish between the Memorandum of Association and the Articles of Association of a Company Mention some of the important clauses in each

10 Explain the risks which are usually covered by Marine Insurance What is the difference between *general average* and *particular average* ?

11 What do you mean by a negotiable instrument ? In what respects does it differ from a transferable document ? Give examples of each

12 State the meaning of the legal doctrine *caveat emptor*. Distinguish between a *condition* and a *warranty* in a sale of goods

INDEX

ELEMENTS

OF

CORPORATION FINANCE

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Preface

A corporation or company is the institutional device for large-scale organization of energies and resources. It is a social and economic institution that touches every aspect of our lives today; in many ways it is an institutionalized expression of our way of life. During the last 50 years or so, industry in corporate form has moved from the periphery to the very centre of our social and economic existence. Indeed, it is not inaccurate to say that we live in a corporate society. The corporation has come to occupy a dominant place in a modern society; it leads, moulds, directs and determines our perspective; around it crystallize our social problems and to it we look for their solution. The serious food crisis has led many to find a solution in the joint stock form of farming. The large corporations are the chief agencies of private research. We look to them for the technical improvements that spark our economic growth. They are the hope of fund raisers for institutions of higher learning and the principal consumers of the products of those institutions. Their advertising campaigns support newspapers and sponser TV programmes. They are a leading purveyor of influence and pressure on public officials. Certain Ministers are said to be in the pay of the Birlas who have a 'grip' over the Congress Parliamentary Party, the administration, and the Ministry of Industry.[1]

The corporate sector is thus the vital section of our economic life. Nearly 27,000 companies in India are primarily responsible for the industrial and economic development of the country. The credit for the introduction of the modern technique of production, large-scale operation and fuller utilization of resources goes to them. The share of companies in the factory output is 92%, in the productive capital of factories 91% and in the revenue of the Central Government 50%. The share of the corporate sector in the gross fixed assets and gross capital stock of large and medium-sized industries in the country is 82% of the private sector. The corporate sector now covers so large an area of the industrial and commercial field that the structure and mechanics of corporate management and finance have become subjects of great practical importance and separate sciences in themselves.

1 *The Economic Times*, dated 27-5-67

The purpose of the present study is to present an objective analysis of the various problems involved in the science and art of corporate finance. We have endeavoured to study as to how, from what varied sources and through what intricate processes the required financial resources in cash and credit, are obtained and canalized in the modern corporate enterprise. The processes of corporate promotion, formation, organization, etc. have also been dealt with in brief. The chief characteristic and the utility of this study lies in the fact that we have largely tried to present the Indian point of view and examined the Indian corporate sector and its practices and problems, by drawing suitable illustrations from the working of our corporate sector. To give a correct idea and accurate information we have given full details in appendices of well known historical events of corporate finance and working.

The book has been designed as a text-book for post-graduate students of Indian Universities in corporation finance. There is continued emphasis upon relations between the corporation and outside interests—investors, the public and the government. Concreteness is given to both practices and underlying principles by the use of illustrative cases. They serve as guideposts for the area of activity concerned. They also impart a sense of reality that may bridge the gap between the quiet class-room and the dynamic world of business in action.

We shall welcome suggestions to make the book more useful.

Raja Balwant Singh College — *AUTHORS*
AGRA
June, 1967

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The Corporate Organization

The terms 'Company' and 'Corporation' are significant in regard to the corporate organization The term 'company' is derived from the Latin word *companis* (*com*=with or together+*panis*=bread) and refers to an association of persons who took their meals together In the past merchants took advantage of festive gatherings to discuss business matters In the modern sense 'company' is an association of individuals formed for some common purpose It is an artificial person created by law It signifies so large a number of members that it cannot aptly be called a firm or a partnership Lord Justice *Lindley defines a company as follows "A company is a voluntary* association or an organization of many persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profit and loss arising therefrom The common stock so contributed is denoted in money and is the capital of the company The persons who contribute it or to whom it belongs are members of the company The proportion of capital which each member is entitled to is his share The shares are of fixed value and the whole capital of the company is divided into equal number of shares The shares are generally transferable, although, under certain circumstances, the right to transfer may be restricted

The word company is commonly used in Great Britain and Europe, and the word corporation is popular in the U S A The term corporation was defined for the first time by Chief Justice Marshall in 1819 as follows

"A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, *either expressly or as incidental to its very* existence "

The latest definition is that of the United States Supreme Court as "an association of individuals united for some common purpose, and permitted by law to use a common name and to change its members without dissolution of the association "

Since it is an artificial person, separate and distinct from those who own it, the corporation has the right to perform as a natural person all the functions expressed in the provisions of its charter granted by the state Hence a corporation can buy sell own, manage, mortgage, and dispose of any property both real and personal, which it possesses and it may sue and be sued Contrary to general opinion, a corporation can be organized for non profit as well as for profit purposes

In the U S A, a distinction is made between a joint stock company and a corporation A joint stock company in the U S A is created by a contractual agreement of the organizing parties which is not required to be filed It usually provides for a Board of Directors and officers to conduct the business and issuance of certificates for capital units which may be freely transferred or sold, but the liability of each contributor remains unlimited The corporation, on the contrary, requires incorporation It requires a special grant of power from the state The persons interested must agree upon the general outline of powers and relations and create an application in the form of articles of incorporation These articles are to be presented to the proper state office with the request for a charter In size, a corporation is larger than a company The corporation emphasises the legal personality of the business unit Blackstone wrote in 1765 that "as all personal rights die with the person it has been found necessary to constitute artificial persons, who may maintain a perpetual succession, and enjoy a kind of legal immortality called bodies politic, bodies corporate or corporations"

Evolution of the corporation—History of evolution of the corporation is the history of the evolution of the big business Two centuries ago economic activity was largely a hand process operation carried out in individually owned businesses, today the activity is dominated by the operation of complex mechanical integrations using steam, electric or oil power under the control and ownership of corporations In the days of small business one began with a few hundred rupees of one s own capital, or with an equally modest amount of capital contributed jointly by friends and acquaintances who became partners Today a business is often begun by incorporation[1], it may obtain crores of rupees of capital by selling shares and debentures to an investment banking house or other financial institution, which, in turn, resells them to any stranger In modern business the corporation is the most important legal form of ownership in terms of wealth, number of employees and total income

While the corporation may not be the cause of the increased scale of production, there can be no doubt about the mutual dependence of large scale production and the evolution of the corporation The history of the corporation as a business unit begins with

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1 To 'incorporate' means to form into a body to combine elements previously separate and apart, each body behaves differently and has different attributes than would its unassociated parts. Furthermore the parts themselves will behave differently after they are associated than they would if left independent

the history of the joint stock company There are interesting analogies between both and their earlier counterparts, the guilds, crafts, boroughs and manors Early Rome, medieval England, or colonial America had their business units, some of which possessed considerable corporateness

Being a gregarious animal, man prefers to make his living and live his life in groups To them, real and important as they seem to him, he attributes personality, oneness and corporateness The family, the tribe and the clan, the town and the nation, the club, union, community, church—all become entities once they are taken seriously Greek cities, Roman towns, medieval monasteries, boroughs, craft and merchant guilds, were all social, economic, political or religious units to which their contemporaries attributed 'corporate' personality Each had rights, powers and duties peculiarly its own Sometimes these bodies were granted privileges by the state or church and sometimes they appropriated the privileges first and obtained the sanction of authority afterwards

The device of *institutional immortality* was known to the guilds several centuries before transferable shares were invented The concept of *perpetual succession*, the right *to hold property*, the use of *common seal*, management through *elected officers*, the provision of *annual audits*—all these were clearly *corporate* in their nature, serving to mutualize the interests of guildsmen They forecast the modern corporation These were the attempts of men to vest their economic enterprises with corporateness, to gain power by uniting, to acquire the character of sovereignty [1] It may be remembered that these guilds were incorporation of producers, traders, merchants, professionals, etc Later the villages, the churches, and the municipalities utilized the principles of the corporation to secure the permanence and individuality which were more or less essential to the complete exploitation of their shares

The opening of the Western Hemisphere late in the 15th century made possible an extension and development of the known world scarcely imagined before that time Trading vessels opened a trade reservoir and a market outlet almost beyond comprehension There was a large amount of capital being created , yet there were few opportunities, especially for the great middle classes, to employ it A lawyer, a physician, a retired merchant, who had saved some thou sands and who wished to place them safely and profitably, was often greatly embarrassed [2] An institution which could meet some of

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1 A 13th century merchant guild forcing non-members to trade only in full publicity , a 15th century craft guild in the act of regulating price and quality , burgesses assembled during the 14th century, to pass codes regulating the activity of foreign merchants , the Russian Company (first of the joint stock *companies in England, 1553*) *requesting* a Charter that would grant it sole trading rights with Russia—are the well known examples.

2 In 1850s England was swept with a wave of concern for the small investor How might the savings of the middle and labouring classes be conserved and yet *kept free of the potential penalties* of unlimited liability ? The laws of partnership interfered

these needs was found in the corporation or the joint stock company

The joint stock company is the product of Great Britain The first joint stock company formed there was the Russian Company formed in 1553 with the object of sole trading rights with Russia. The famous East India Company was formed in 1600 the New River Company a few years later, the Hudson s Bay Company in 1670, and the Bank of England in 1694 In those days such companies were incorporated either by special Act of Parliament or by Royal Charter, but there existed also a number of bodies such as would now be called 'Companies', carrying on important business (e g. banking and insurance), which were not incorporated and in the eye of the law were only private partnerships The law did not view such bodies with favour, and it was not till 1844 that companies could obtain incorporation otherwise than by Special Act or Royal Charter

The railroad era is known as the second stage in the development of the corporation when the principle of incorporation was widely used in general business and transportation Practically speaking no railroads were constructed and operated except under the corporate form of business organization In America the railroad occupied the very centre of financial problems

The last stage in the development of the corporation is said to have begun after 1850 when the principle of limited liability was adopted and reforms and refinements took place After the Civil War in the U S A, the corporation received both political and economic encouragement The corporate organization acquired an important place in those lines of businesses where large scale production was the rule As business emerged from the panic of 1873 ventures that had been partnerships or proprietorships reorganized themselves under the corporate form. The corporation was favoured because it permitted the raising of large amount of capital with less risk to both the saver and the promoter as well as a centralization of managerial control. Now the corporation has become the most important form of business organization in the U S.A. and elsewhere The number of partnerships in the U S A. was at its peak in 1924, but thereafter the corporations outnumbered them. The increased use of labour-saving machinery, the tendency to integrate business activities under a central ownership, the trend towards large-scale enterprises and the advantages of assembling large sums of capital under the control of a single management are factors that have helped to increase the popularity of the corporation as a form of ownership There is even a growing trend towards the use of the corporation in small business because of the advantages not found in the partnership or individual proprietorship

The chief advantages of the corporation over proprietory and partnership concerns may be discussed briefly These advantages have made corporate form of business as the most popular type of organization these days

(1) *Limited liability*—Liability is usually limited to the amount of shares or stock issued

(2) *Continuity of existence*—Change of ownership through the transfer of shares or stock has no effect on the existence of the corporate form

(3) *Continuity of management*—Change of ownership through the transfer of shares or stock need not affect management

(4) *Skill and flexibility of management*—The management of the corporation is placed in the hands of a Board of Directors The wisest and most skilful directors may be chosen Their investment in the corporation need not be large

(5) *Acquisition of new capital*—A successful corporation may seek as much capital as it needs Investors have greater confidence in the securities of a corporation than in those of other forms of business The corporation has succeeded in winning more capital from the saver than any other form of the business unit It has won the investor by offering him ownership with less liability

(6) *Personnel advantages*—The corporation can offer more opportunity to the efficient and ambitious employee, and thus secure top flight personnel Opportunity to secure share or stock in the corporation is an incentive to effort

(7) *Limitation of power to bind*—Any one partner can bind all his partners, perhaps disastrously Power to bind the corporation is limited to designated directors, officers and agents

(8) *Control of minorities*—While minorities have adequate representation, dissident minorities are usually not as difficult to manage as they are in partnerships

(9) *Transfer of interests*—Interest in the enterprise, evidenced by shares or stock, is readily transferable Corporate shares provide a means of investment that can be transferred to heirs with comparative ease A partner's heir cannot succeed to his status as a partner without the consent of the other partners

Thus, since the Industrial Revolution the proprietory concerns and the partnership firms have more and more been replaced by the joint stock form of industrial organization The latter connotes a large size with regard to capital, employment, operation, organization and management as compared with the proprietory and partnership industrial concerns It also presupposes more and more use of machinery, scientific devices and technological methods As a consequence the corporate form of organization today is responsible for the largest share of the world's industrial production trade, transport and other economic activity It has completely transformed the economic life of India Nearly 26,000 joint stock companies in India are primarily responsible for the industrial and economic development of the country on modern lines As one observer has put it, they virtually legislate the standard of living of the people , they represent economic democracy in action and provide useful countervailing force in society without which no democracy can survive

In the U S A (in 1947) 49% of all manufacturing establishments were organized as corporations, 29% as proprietorships, 21% as partnerships and 1% in other forms Corporations also employed 89% of all the productive workers and produced 92% of the total value of product in the manufacturing field In merchandising, the corporation also dominates the wholesale division where 50% of the number of wholesale establishments are corporations and they enjoy 76% of the total sales and employ 77% of the employees

Importance of Corporate Activity, by Branches of Industry in the U.S A.[1]

	Industry	*Percentage of National Income in 1937*	*Percentage of Business done by Corporations (1929 37)*
1	Agriculture	8 9	7
2	Mining	2 1	96
3	Electric light and power and manufactured gas	1 6	100
4	Manufacturing	24 0	92
5	Contract construction	2 1	60
6	Transportation	7 3	89
7	Communication	1 3	100
8	Trade	12 5	58
9	Finance	9 3	84
10	Government	13 5	58
11	Service	11 9	30
12	Miscellaneous	4 2	33

Among the twelve groups of activities listed in the table above, in only three groups (agriculture, service and miscellaneous) do unincorporate enterprises perform the major part of the business done In all others the corporate enterprise predominates These three industrial groups accounted for 25 per cent of the national income produced in 1937 In six industries, originating about 45 per cent of the national income in 1937, corporations accounted for 80 per cent or more of the business done In the manufacturing group, which alone accounts for about one fourth of the national income, 92 per cent of the business was done by corporations

A joint stock company, better known in the U S A as the corporation, is an association of persons organized into an autonomous legal unit with a distinct legal personality that enables it to carry on business, own property and contract debts through its agents and officers It signifies so large a number of members that it cannot aptly be called a firm or a partnership

The most striking characteristics which distinguish a corporation from other forms of business enterprises are

[1] *Robert Aaron Gordon Business Leadership in Large Corporations 1945* p 13

(1) *Legal personality*—The most peculiar characteristic of a corporation is its artificial personality It is something more than a mere form or way of doing business It is a child of the state and possesses a legal personality which enables it, through its agents or representatives, to do many of the things that a natural person does It is a person almost like a human being As such it is capable of owning property, incurring debts, borrowing money, having a banking account, employing people, entering into contracts and suing and being sued in the same manner as an individual The people who organize a company are not the company itself but are its owners But they can also be its creditors at the same time since it has a separate legal entity A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital A shareholder is also not an agent of the company and so he cannot bind it by his acts The property acquired by the company does not belong to the owners of the company, but to the company itself

(2) *Limited liability*—A member of a company is liable to make good the loss of the company only to the extent of his share If some amount is uncalled upon a share he is liable to pay it but not beyond that The creditors of a company can obtain satisfaction for their claims only out of such property as the company may own Property of a proprietor or a partner, on the other hand, may at any time be levied upon regardless of whether it is among the business assets or the owner's personal assets

(3) *Ease of transferring ownership interests*—In the partnership, ease of transfer does not exist, partly because it would permit the injury to creditors through the sale of ownership from strong to weak hands after a granting of credit, and partly because of the possible injury to the remaining partners should one of their number relinquish his interest and place in the hands of a person who is financially weak, incompetent or dishonest The owner of a share in a corporation may, however, transfer his interest whenever and to whomsoever he pleases The shares of a member of a company are termed as a movable property which is freely transferable in the manner provided for in the articles of the company They can either be directly transferred to other interested persons or can be marketed through the organized stock exchanges No consent of other members is needed for this transfer The owner of a sole proprietorship can transfer his interest, subject to the claims of existing creditors against him but there is the difficulty of finding persons who have large enough cash to make the purchase In contrast, the owner of a company's shares can offer an investment divided into units of convenient size and potential buyers need assume no responsibility for operation

(4) *Permanence of organization*—The individual proprietory business begins and ends at the will of the owner, save of course that it must end with his death Partnership as a personal relationship among a group of men begun by their mutual agreement is brought

to an end by the death, withdrawal, bankruptcy or legal disability of any single partner His interest cannot be transferred to another by gift or by will But incorporation into a company offers relief from the dangers of dissolution which may lead to the liquidation of the business *The life of a company is not dependent upon the lives* and activities of its members and therefore the duration of its business is not affected by their misfortunes Every original member may die, every original member may become individually insolvent, every original member may withdraw from the company and yet the life of the company will *continue* The life of a company is perpetual or definite by the terms of its charter In any case it has a long life Some of the states in the United States limit the maximum life period of companies which varies from 20 to 100 years As a result of long or perpetual existence the company can enter into contracts extending over many years It can undertake programmes of construction requiring as much as a quarter of a century for their completion. It can offer to the investor a permanent and safe resting place for his income earning funds

(5) *Special taxes*—The company has to pay a price for the advantages of its creation by the state in the form of special taxes levied against it, whereas the sole proprietorship and the partnership enjoy freedom from taxes levied on the form of organization as such The company has to pay an incorporation tax based on the amount of authorized capital, tax on net income and profits

(6) *Expense and difficulty of starting*—The sole proprietor has no problem or expense in starting his business which can be attributed to the form of organization He begins business without formality The partnership is similarly an informal type of organization and may legally exist without any written contract among members The creation, however, of a corporation gives rise to much expense and effort The formalities involved, the legal expenses and the fees and taxes incurred are the sort of barriers which give rise to difficult questions.

(7) *Government regulation*—While the businesses of particular proprietorships or partnerships may be regulated because of their nature, neither form of organization is regulated *per se* The company is a 'person' created by law and is identified with 'big business', it attracts special legislation which is often burdensome The Indian Companies Act is one of the largest and most complicated legislations of the world The provisions of the Act require companies to submit certain returns and reports and affect their working in many other ways

(8) *Limitation of action*—A company cannot go beyond the powers of its charter—the memorandum of association Its action is therefore limited In order to enable it to carry out its actions without much restrictions and limitations, in most cases, sufficient powers are taken in the memorandum of association But once the powers have been laid down, it cannot go beyond unless the memorandum is itself altered.

Type of companies—According to the mode of incorporation there are three type of companies (i) chartered companies, (ii) statutory companies, and (iii) registered companies *Chartered companies* are the oldest and the earliest of all companies They were incorporated in England before the second half of the 19th century, viz, the East India Company (1600), the Hudson's Bay Company (1670), the Bank of England (1694), the Peninsular and Oriental Steam Navigation Company (1840) These were incorporated under a special charter granted by the king or the sovereign Such a company incorporated by a Royal Charter has very wide powers Its powers are circumscribed by the directions contained in the charter *Statutory companies* are incorporated by a special Act of the state legislature or the Parliament These companies are formed for the *purpose of carrying on some business of national importance* A statutory company is governed by the terms of its special Act It is a limited liability concern, but is not required to use the word 'Limited' as part of its name Well known statutory companies in India are the Reserve Bank of India, the State Bank of India, the Industrial Finance Corporation, State Industrial Finance Corporations, the Damodar Valley Corporation *Registered companies* are by far the largest class of companies and most popular in India and elsewhere *They are incorporated under the* Companies Act Barring the statutory companies all other companies in existence in India have been formed in this way by registration under the Indian Companies Act Certain companies, though registered under the Companies Act, are governed in many important operative matters by the provisions *of special enactments, e g, banking, insurance and electricity* supply companies The special Acts applicable to these companies are the Insurance Act of 1938, the Electricity Supply Act of 1948, and the Banking Companies Act of 1949

Kinds of registered companies—The Indian Companies Act provides for the registration of three kinds of companies (a) *companies limited by shares*, (b) *companies limited by guarantee*, and (c) unlimited companies A company in the first two categories may be either a private company or a public company

(a) *Limited companies*—Companies limited by shares are popularly known as limited companies because the liability of their members is limited by the nominal or face value of shares held by *them* They are also termed as joint stock companies and are defined as "having a permanent paid up or nominal share capital of fixed amount divided into shares, also of fixed amount, or held and transferable as stock, or divided and held partly in the one way and partly in the other, and formed on the principle of having for its *members the holders of these shares or that stock, and no other* persons" Thus, these companies must have share capital of a permanent nature and can admit as members only persons who hold their shares and not others In the case of these companies share capital is compulsory since the magnitude of a member's liability is determined by the face value of shares held by him They provide a

special attraction to the investor since the liability of a member, in the event of the company being wound up, is limited to the extent of the amount that remains unpaid on such shares. The liability does not fluctuate, but is always equivalent to the amount which, for the time being, remains unpaid whether from the original shareholder or the transferee of such shares, as the case may be. The person who invests money in such a company as a shareholder knows exactly beforehand the amount of the risk involved in the investment and the maximum limit of his liability.

(b) *Guarantee companies*—The liability of the member of a guarantee company is limited to the amount he undertakes to contribute to the assets of the company in the event of its being wound up. The guaranteed amount is mentioned in the Memorandum of Association. Each member guarantees to pay the fixed amount but is not required to pay until the company is wound up, i.e., it is not enforceable during the lifetime of the company. Such companies are generally formed for non trading purposes, e.g., charitable activities, and for the promotion of art, science, sport, etc. The chambers of commerce and trade associations and sports clubs are usually guarantee concerns. The object of such companies is not to make profit and distribute dividend, but to render service to the community. Such companies may or may not have share capital. In the former case, each member is also liable for any amount remaining unpaid on his shares.

(c) *Unlimited companies*—Such companies are rare these days. They are little more than an ordinary partnership, each member being liable for the debts of the company to the last paisa. Unlimited liability is co extensive with the debts of the company and is enforceable only at the time of the winding up of the company.

Private companies—A company limited by shares or by guarantee may either be a private company or a public company. A 'private company' is one which by its articles restricts the right to transfer its shares, limits the number of its members (excluding present and past employees) to fifty, and prohibits any invitation to the public to subscribe for shares or debentures of the company.

Public companies—A company which by its articles does not provide for the restrictions so as to make it a private company, is termed as public company. Usually the number of members of a public company is very large and there is no maximum limit to membership.

For a limited liability company the number of members should not fall below two in the case of a private company and not below seven in the case of a public company.

Government companies—A Government company is a new term and indicates Government's stake in a company. A company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State

Governments, is termed as a Government company and includes a company which is a subsidiary of a Government company

Foreign companies—On the basis of nationality, companies may be *Indian or foreign* Foreign companies are those incorporated outside India but have a place of business in India A company, the registered office whereof is in Burma, Aden or Pakistan and which immediately before the separation of that country from India was a *company as defined in the Act is a foreign company* These companies have to comply with some of the provisions of the Indian Companies Act

Holding companies—Holding company and subsidiary company are *relative terms* A holding company is one which (a) controls the composition of the Board of Directors, or (b) holds more than half the nominal value of the equity share capital of another company If company A is entitled to appoint 4 out of 7 directors in company B or holds a majority of nominal value of the equity share capital in company B then company A is the holding company of B

Subsidiary companies—A company under the influence of a *holding company is termed as its subsidiary If company A is entitled to appoint 4 directors out of 7 in* company B or holds more than 50% of the equity share capital then company B is a subsidiary of company A If company A is the holding company of B and B is the holding company of C, then both the companies B and C are subsidiaries of A

One-man companies—The provisions of the Companies Act have sometimes been so used as to enable even a single individual to trade with limited liability and the term one man company is *often colloquially used to denote a company* (usually private) in which substantially the whole of the shares are held by one person There are, of course, a few other members holding one or two shares each as to comply with the requirements of the Act, but they are usually nominees, friends, family members or relatives of the principal shareholder who is the virtual owner of the business Most of the Government companies registered as private companies are of this type since the *entire shares are held in the name of the* President of India and a few shares are held in the name of some official of the department of the Government The formation of such companies is fully legal and such companies have a corporate *existence*

Formation of companies—A company is a large organization and requires large-scale and arduous efforts at the time of its formation From the time of the conception of the idea to the time of *actual functioning of the corporation*, a lengthy process is involved, spread over a long period of decades sometimes The process of formation of a company is divided into three distinct stages (1) the promotion stage, (2) the *registration or incorporation stage, and* (3) the commencement of business

(1) *Promotion*—This is the stage in which the idea of forming

a company is conceived either by a person or by a group of persons who are called promoters These promoters are experts in the line and have ample experience of company formation After conceiving the idea, they have to work it up with the help of their own resources and skill In matters of detail respecting procedure and prospects they have to seek the assistance of several experts like solicitors, lawyers, engineers, accountants auditors etc

The idea conceived of may be embodied in an invention, a process of manufacture a method of merchandising a form of organization a plan of financing or a combination of two or more devices The promoters need not themselves be the discoverers of the idea, they may simply find out its commercial possibilities A company may be formed either for taking over an existing proprietory concern, a partnership firm or an existing company or for starting an altogether new business *In the former* case *the promoters* have *to negotiate* with the vendors with a view to settle terms and enter into preliminary *contracts for the purchase of assets The preliminary contracts* contain the detailed description of the property and assets, their purchase price settled mode of payment, etc If, on the other hand, a company is formed to start an altogether new business, development of the proposition is essential

After the idea has been properly developed, another important step is to prepare the Memorandum of Association and the Articles of Association of the proposed company The Memorandum defines the objects and determines the status of the company and the Articles lay down the rules and regulations for the management of the company and for carrying into effect the objects as laid down in the Memo-*randum After being drafted these documents have to be printed*

The promoters thereafter find out persons who will join hands with *them in the formation of the company At least seven persons* are needed to form a public limited company and two to form a private company The persons who so agree to join hands, have to sign the Memorandum and the Articles

Before 1956, much of the work of company promotion was done by managing agents, but since the coming into force of the Companies Act, 1956, the managing agency system has declined considerably The National Industrial Development Corporation set up by the Government of India in 1954 has taken up the work of company promotion, to a limited extent particularly in the field of the basic and heavy industries in the public sector The Government itself, in collaboration with foreign experts, does a good deal of work in regard to the floatation of new industrial concerns In foreign countries there are special agencies to do the work of company promotion

The chief functions of a promoter are

(i) To conceive the idea of forming a company and to explore its possibilities

(ii) To conduct the necessary negotiations in connection with the purchase of a private business, if any, which is to be taken over

by the company, and to enter into provisional agreements with the vendors

(iii) To obtain reports on the business to be purchased if any, from professional experts such as accountants and valuers

(iv) To get together the number of persons who will sign the Memorandum and the Articles and will act as directors

(v) To settle the name, the registered office and objects of the company, the amount and form of its capital, and to enter into underwriting contract if necessary

(vi) To select bankers, brokers auditors, legal advisers etc

(vii) To have the Memorandum and the Articles drafted and printed

(viii) To undertake the registration of the company including the payment of fees payable before registration and to obtain the certificate of incorporation

(ix) To arrange for preliminary contracts with vendors, underwriters and managing agents, if any

(x) To make arrangements for the preparation of the prospectus, its filing and advertisement

(xi) To make arrangements for the issue of capital

(xii) To defray preliminary expenses.

(2) *Registration or incorporation*—It is registration that brings a company into existence A company is properly constituted only when it is duly registered under the Companies Act and the Certificate of Incorporation is obtained from the Registrar of Joint Stock Companies For the purpose of registration of the company the promoters have to take the following steps

(i) *Sanction for capital issues*—Under the present regulations relating to capital issues, it is permissible for companies to issue capital up to Rs 25 lakhs without the consent of the Central Government But for issues of capital in excess of this limit, an application for sanction has to be made under the Capital Issues (Continuance of Control) Act, 1947, in quintuplicate, to the Controller of Capital Issues, Ministry of Finance, Department of Economic Affairs, Government of India, New Delhi, accompanied by a treasury receipt for Rs 50 as fee and a copy of the draft prospectus.

(ii) *Licence under Industries (Development of Regulation) Act, 1951*—Where the capital proposed to be issued is in respect of an industrial undertaking for which a licence has to be obtained under the Industries (Development and Regulation) Act, 1951, an application for licence has to be made simultaneously on a prescribed form to the Secretary, Ministry of Industry, Government of India, New Delhi

(iii) *Availability of name ascertained*—The promoters should ascertain from the Registrar of Joint Stock Companies that the proposed name of the company is available for registration otherwise the work of registration will be delayed and difficulties may arise

(iv) *Filing of documents*—After all the preliminaries have been settled finally the promoters send an application to the Registrar of Joint Stock Companies of the State where the registered office of the company is to situate The application is to be accompanied by the following documents

(1) Memorandum of Association
(2) Articles of Association
(3) List of persons who have consented to become directors
(4) Written consent of directors to act as such
(5) Directors undertaking to take up and pay for qualification shares
(6) Agreement, if any with Managing Agents or Secretaries and Treasurers
(7) Statutory declaration by an advocate of the Supreme Court or a High Court or by an attorney or a responsible officer of the company that all requirements of the Companies Act 1956 and the rules thereunder have been complied with in respect of registration and other matters pertaining thereto
(8) It is also customary to file the notice of the registered office of the company, though it may be filed within 28 days after the date of incorporation.

Along with the above documents, the necessary stamp duty, registration fees, and the filing fees have to be paid. The Registrar will receive these documents and will grant a receipt for the fees paid. The duty of the Registrar on receiving these documents is to examine them to see whether the statutory requirements have been complied with The statutory requirements to be observed are

(1) That the Memorandum is signed by the requisite number of persons.
(2) That the proposed company is formed for a lawful purpose
(3) That the Memorandum and Articles do not infringe the provisions of the Companies Act
(4) That the name is not prohibited, or is not the same as that of an existing company, or so nearly resembling it as to be calculated to deceive

The Registrar will also scrutinize the statutory declaration If he is satisfied that all the requirements have been complied with by the company and that it is authorized to be registered under the Companies Act, he will retain and register the Memorandum, the Articles, if any, and the agreement etc He will then issue a certificate known as the 'Certificate of Incorporation' certifying under his hand that the company is incorporated and in the case of a limited company that the company is limited

(3) *Commencement of business*—A private company can commence business and, if so authorized, exercise borrowing powers as

soon as it is incorporated, but other companies having share capital cannot do so A public company even though incorporated cannot begin its business unless it obtains the 'certificate to commence business' For the purpose the following steps have to be taken

(i) *Raising of capital*—After incorporation of a public company a copy of the prospectus is filed with the Registrar of Companies and it will be issued to the public inviting applications for shares The intending investors can get the prospectus and the application form free of charge from the company's bankers or from its registered office They submit the applications for shares along with the necessary money to the company's bankers The bankers collect the applications and forward them to the company The directors, after the minimum subscription is received, proceed to allot shares to the applicants and issue share certificates in due course

(ii) *Filing certain documents*—The company will file the following documents with the Registrar

(a) Prospectus or statement in lieu of prospectus

(b) Notice of the situation of the registered office if not already filed

(c) Declaration by the company that minimum subscription has been collected

(d) Declaration by the company that the directors have taken up and paid for their qualification shares

(e) Declaration by the Secretary or a Director that all the legal requirements precedent to the commencement of business have been complied with

On receipt of the above documents, the Registrar will satisfy himself about the fulfilment of the formalities and then will allow the company to begin business by issuing the certificate for the commencement of business After this, the company can start operations

Company Management

The shareholders of a company are collectively the owners of the company, but it is only indirectly that they may consider themselves as the owner of what the company owns The legal title to the assets of the company, in other words, is vested in the company as a separate legal entity As long as the company exists, its owners may not take title to its property Each shareholder, however, owns a portion of the company, represented by the number and kind of shares which he holds It follows therefore that shareholders have the functional right to manage the affairs of the company The actual right to control and manage the affairs of a company vests in the directors There are several reasons for the separation of management of a company from its ownership Firstly, the number of shareholders of a company is generally very large, sometimes running over thousands Secondly, they are scattered over a very wide area since many companies have international membership

Thirdly, the shares of a company are freely transferable and every transfer of shares involves a change in the membership of the company. Consequently, it is impracticable and undesirable to entrust the management of a company to such an ever-changing body of persons, as every change is likely to effect a change in the policy of management. Lastly, the complexity of modern business requires separation of management from ownership since only experts are expected to manage the affairs of a large and complex business and shareholders are not expected to possess such knowledge.

On the analogy of the representative form of government, the management of a company vests in a body of elected representatives known as directors. The directors as a body are termed as the Board of Directors or simply the Board. Hence the law requires that every Company should have directors to manage its affairs. The Board is the ultimate executive authority of a company.

In the early stage of development of the concept of limited companies, it was considered that the general meeting was the company in its body corporate whereas the directors were merely agents subject to the control of the company in general meeting. But this concept gradually changed and the doctrine that the directors alone could manage the affairs of the company gained ground. It was realized that the control and regulation by the general meeting of shareholders, which elected the directors, could only be confined to matters specially reserved for the authority of the general meeting in terms of the articles. A company now is entirely a separate entity distinct from its shareholders and its directors.

The directors, being generally part-timers, are not expected to be present at all times at the office of the company. The need therefore arises for other persons to look to the day-to-day management of the affairs of the company. Thus, the management of a company consists of: (1) the Directors, (2) the Managing Director, (3) the Managing Agent, or the Secretaries and Treasurers, (4) the Manager, (5) the Secretary, (6) the Legal Adviser, and (7) the Auditor. All the agencies work under the control and direction of the Board and are subordinate agencies of management.

Prior to 1956 by far the most important agency of company management in India was the managing agents, but since the adoption of the policy of their gradual elimination under the Companies Act, 1956, there has been a considerable decline in the popularity of management by managing agents. Now the companies formed in recent years have preferred the Board of Directors to manage their affairs. The other agencies of management adopted by the companies, in order of importance, are Managing Directors, Managers and Secretaries and Treasurers. The Secretaries and Treasurers and Managers play a minor role as yet in the management of the companies. The position occupied by various agencies of management in the management of companies is shown in the following table.

Form of management adopted by new companies

Form of management	1960-61 No	1960-61 % of the total	1961-62 No	1961-62 % of the total	1962 63 No	1962 63 % of the total
1 Directors	1062	.	1063		1072	
2 Managing Directors	596		515		388	
3 Managing Agents	21		29		34	
4 Managers	3		4		1	
5 Secretaries and Treasurers	1		3		2	
Total	1683		1614		1497	

Directors

Definition—Under Section 2(13) of the Companies Act, "the term 'directors' includes any person occupying the position of director, by whatever name called Director is one of the officers of the company Section 307 (10) (a) further holds that any person in accordance with whose directions or instructions the Board of Directors of a company is accustomed to act, shall be deemed to be a director of the company "

The directors stand in a fiduciary position in relation to the company they manage Their position resembles in some respects that of trustees, in some respects that of agents, and in other respects that of the managing partners

Number of directors—A company may have any number of directors according to the provision in its articles, but a private company must have a minimum of two and a public company at least three directors A company may increase or reduce the number of directors by altering the articles, but for increasing the number beyond the maximum fixed in the articles, approval of the Central Government is necessary Within the maximum number fixed in the articles, the directors can appoint additional directors who retire at the succeeding annual general meeting of the company

No person can be a director in more than twenty companies at a time, but in computing this number of twenty the directorship of a non-subsidiary private company, an unlimited company, a non profit association and an alternate directorship of any company is excluded

Appointment of directors—The first directors of a company are usually named in the articles If the articles do not name them, the subscribers of the memorandum or a majority of them may appoint the directors, failing which subscribers themselves are deemed to be the first directors of the company

The first directors hold office only till the first annual general meeting of the company is held At the first annual general meeting and subsequently every year the directors are appointed by the

company in general meeting In the case of public companies and their subsidiaries, at least one-thirds of the directors retire every year by rotation at the annual general meeting of the company and are replaced by new ones

The board is empowered to appoint additional directors alternate directors (in place of a person leaving for more than 3 months the state where meetings of the Board are generally held) and to fill in any casual vacancies occurring by resignation death or insolvency

Sometimes the managing agents are also authorized to appoint directors by means of a provision in the articles This power however is limited to one director if the total number does not exceed five, and to two if the total number exceeds five A complaint having been lodged with the Central Government that the affairs of a company are being conducted oppressively or in a manner prejudicial to the interests of the company itself the Central Government can appoint a maximum of two directors

No minimum qualifications are prescribed for the appointment of directors, but the articles of companies require the directors to hold a few qualification shares At least one share must be held by a director which may be acquired by him within two months of his appointment In no case the nominal value of qualification share or shares should exceed Rs 5,000

Duties of directors—A company being an artificial person, can operate only through a human agency and directors are such an agency Important duties of the directors are (i) to carry on the day to-day business of the company efficiently, (ii) to enter into contracts for and on behalf of the company, (iii) to look after the property and assets of the company, (iv) to see to the proper investment of its funds, (v) to manage the affairs of the company well The directors must discharge these duties honestly and diligently The Companies Act requires the directors to perform certain specific duties regarding filing of certain documents and returns, convening of meetings, etc

Powers of directors—The Board of Directors is entitled to exercise all such powers and to do all such acts and things as the company is authorized to do, except those specifically reserved for the company in general meeting (of shareholders) The Board is also responsible to supervise and control the work of the officers of the company, viz., manager, managing agents, secretaries and treasurers etc Apart from these general powers of management and control, specific powers have been conferred on the Board of Directors by the Companies Act The Act not only prescribes the nature and extent of such powers, but also specifies the manner in which these powers may be exercised As a rule, the directors cannot think without a meeting and the company is entitled to the 'combined wisdom' of the directors in a meeting They are responsible as a body to the shareholders These powers are (i) to make calls, (ii) to issue debentures, (iii) to borrow money, (iv) to invest the funds of the company, (v) to make loans, (vi) to enter into a

contract for the sale, purchase or supply of goods and services Other powers not necessarily to be exercised by means of a meeting are (i) to allot *shares* (ii) *to keep deposited in a scheduled* bank the application money received from applicants, (iii) to call extraordinary meeting on requisition, (iv) to maintain proper books of account, (v) to place before the annual general meeting the balance sheet and the profit and loss account, (vi) to make a report and attach it to annual accounts, (vii) to appoint auditors, (viii) to appoint additional and alternate directors and the managing director, etc

If the directors fail to exercise their powers honestly and diligently they may be penalized for negligence of duty and breach of trust If they do not carry on their duties efficiently, the share holders may remove them before the expiry of their term of office *The age of retirement of a director is 65 years, but* under the proposed Amendment Act, it is being raised to 75 years

Managing Agent

The *managing agent is any individual, firm or body corporate* entitled to the management of the whole or substantially the whole of the affairs of a company by virtue of an agreement with the company or by virtue of its memorandum or articles of association

Number of managed companies—No single managing agent is allowed to manage more than 10 companies at a time In computing this number the managing agencies of a private company, an unlimited company and a non-profit association are excluded

Appointment and reappointment—The appointment of a managing agent is made with the approval of the shareholders in a general meeting and the Central Government The Central Government grants approval after having been satisfied about the following

(1) It is not against public interest to allow the company to have managing agents

(2) The proposed managing agent is a fit and proper person

(3) The conditions of the proposed managing agency agreement are fair and reasonable

(4) The managing agent must have fulfilled the conditions required by the government

No company is allowed to reappoint a managing agent for a fresh term any time before 2 years of his current term remain *unexpired* *The object is to thwart the practice of securing from the* existing shareholders a renewal of a managing agency agreement long before the expiry of the existing contract

The term of office of a managing agent, if appointed by a company for the first time (i.e., the company was not managed by a managing agent till then), is 15 years If a company wants to reappoint X in place of Y as its managing agent, the term of office of such managing agent will be 10 years only The Central Government, however, allows in practice the appointment of managing agent, for the first time for a term *of 10 years and reappointment for 5 years only*

The following companies cannot have managing agents to manage their affairs

(1) All banking and insurance companies

(2) A company acting as managing agent of another company shall not appoint a managing agent for itself

(3) A company having secretaries and treasurers managing director or manager for its management shall not have managing agents

(4) A Government company

Powers and duties—The managing agents are generally appointed under an agreement with the company The agreement specifies the powers which the company grants to the managing agents By the very definition of the term 'managing agent' he is a person who is entitled to the management of the whole or substantially the whole of the affairs of the company subject to the superintendence, control and direction of the Board of Directors He is an officer in charge of the affairs of the company and must see to the discharge of all the obligations imposed by the Companies Act on the company, such as keeping of registers, books of accounts filing of returns before the Registrar, granting inspection of documents and registers to persons who are entitled to inspection and giving copies of documents to persons who are entitled to receive them, preparing balance sheet, making contracts, drawing and enclosing bills of exchange, calling and conducting of meetings and doing everything necessary to manage the affairs of the company The Board of Directors have to depend upon him for assistance and the employees for guidance

By means of a provision in the articles, the managing agent may appoint one director if the total number of directors in the company is five and two directors if the total exceeds five The managing agent may also be appointed as selling agent outside India of goods produced by the company

Managing agents may receive remuneration for their services from 4 to 10 per cent of the annual net profits of the company

If the managing agents act fraudulently in the discharge of their duties, if they commit breach of trust, if they mismanage the affairs of the company or if they are negligent in the discharge of their duties, the shareholders can remove them before the expiry of the term of office

The new legislation has fully provided adequate checks against the misuse of power by managing agents

Secretaries and Treasurers

Secretaries and treasurers is any firm or company (not being managing agent) which is entitled to the management of the whole or substantially the whole of the affairs of a company, which serves under the administrative control and supervision of the Board of directors and which may or may not be under a contract of service

It means it is a corporate form of management, that is, only a firm or a company can act as secretaries and treasurers They are appointed only when a company has no managing agent, managing director or manager

The functions of the secretaries and treasurers and managing agents are almost alike The remuneration of secretaries and treasurers varies between 3¾ to 7½ per cent of the annual net profits of the company The aim of the creation of this new institution is to replace managing agents in course of time

Managing Director

Managing director means a director who, by virtue of an agreement with the company or of a resolution of the company or the Board or by virtue of its memorandum or articles, is entrusted with substantial powers of management which would not otherwise be exercised by him He exercises his powers subject to superintendence, control and direction of the Board The managing director is one of the directors of the company entrusted with substantial powers of management of the concern which ordinarily he would not exercise as a director A managing director is usually in wholetime employment of the company Articles make provision for the appointment of a managing director The appointment of a person as managing director for the first time must be done with the approval of the Central Government The term of office of a managing director is 5 years A managing director can manage at the same time two companies at the most and no more Remuneration payable to a managing director *may be in the form of monthly salary or a percentage of* net profits or partly monthly payment and partly percentage of net profits

Manager

The term manager, is defined as "an individual not being the managing agent, who, *subject to the superintendence, control and* direction of the Board of Directors has the management of the whole *or substantially the whole of the affairs of the company and includes* a director or any other person occupying the position of manager by *whatever* name called and whether under a contract of service or not." No firm or body corporate can be appointed as the manager of a company Like the managing director, the manager can also manage the affairs of two companies at the most at a time and not more Like the managing director, the manager also can draw monthly remuneration or a percentage of net profits not exceeding 5 per cent or partly one and partly the other The term of office is also restricted to 5 years

Legal Adviser

The company being a legal entity by itself, requires legal advice at every stage of its formation and also during its lifetime It therefore is imperative for it to utilize the services of a legal adviser during

the course of its working Even in the primary formative stage like the preparation of memorandum, articles and prospectus, etc, the promoters can hardly afford to neglect the necessary legal assistance They, therefore, employ the services of solicitors, pleaders or barristers whose names are also mentioned in the prospectus But their appointment is to be confirmed by the company after its incorporation During the course of its working, the company requires legal advice in various matters like the issue of shares and debentures, increase or decrease of capital, undertaking the schemes of reconstruction and amalgamation, etc It may be remembered that the duty of the legal adviser is only of an advisory nature The advice is not binding on the company which may accept it or reject it, as it may like

Auditor

An auditor is the person who is an expert in accounting and is qualified to check the accounts of companies and report on their correctness The audit of a company s accounts by a professional expert is one of the privileges exercisable by the shareholders of a company It is through such audit that the shareholders can ensure that the accounts of the company truly and faithfully represent the financial results of the working of the company The first auditor is appointed by the Board of Directors *within one month* of the registration of a company, and subsequently at its each annual general meeting If the Board fails to appoint the first auditor, the company in general meeting may appoint the first auditor If no auditor is appointed or re appointed at the annual general meeting, the Central Government fills the vacancy The auditor must be a Chartered Accountant

The foremost duty of an auditor is to make a report to the members of the company on the accounts examined by him and on every Balance Sheet and Profit and Loss Account and on every other document annexed thereto which are laid before the company in general meeting He must check the cash in hand and the balance at the bank on the date on which the Balance Sheet is prepared He must see that the securities of the company exist in fact and are in proper custody He should discharge his duties with reasonable care and skill or else he shall be held liable to the company for any loss or damage If he fails to submit a report on the annual accounts, he is fined Rs 1,000 and may also be sued for breach of duty

Secretary

Secretary means any individual, firm or body corporate appointed to perform the duties which may be performed by the secretary under the Companies Act His duties are purely of ministerial and administrative character, they are not managerial, he is not entrusted with the direction control or management of the affairs of the company He is simply an officer of the company serving subject to the direction and control of the Board of Directors He is responsible for the clerical works of the company Being the principal officer of the company, his duties comprise all matters relating to

the conduct of the company's business *As a servant of the company*, he has to carry out such duties as are assigned to him by the Board and visualized by the Companies Act He is responsible for the correctness of the statements and documents filed with the Registrar He must maintain registers, make returns, fix the seal of the company on documents He must arrange for holding of meetings of the Board and of shareholders, prepare and issue agenda, write minutes and execute all decisions made and resolutions passed

2

Corporate Ownership Securities

The concept of corporate ownership

The corporation has introduced a new concept of property to the field of private enterprise Prior to the coming into existence of the company form of organization, owners of business had direct control over the use and disposition of the property which they owned When they used it to obtain profits or enhance its value, the profits or increased value accrued to the owners If costs exceeded the profits or added value, owners absorbed the losses To cover those losses, everything that the owners possessed personal as well as business possessions, could be seized The owners' rights to profits and their liability for losses were enforceable by law

Under the corporate form, the property employed in the enterprise is owned by the corporation and not by the persons who provide it Those who make property available to the corporation own the corporation But it is the corporation, a separate legal person, that has the title to the corporate property Owners receive only a piece of paper representing their individual shares in the equity of the corporation itself This indirect ownership of property is the natural result of giving the corporation a separate personality and represents an abrogation of traditional rights of ownership

Of greater significance has been the separation of control from ownership The owner in a corporation surrenders the right to manage his property , instead, he authorizes directors and through them, officers, to control its use Owners, in exchange for the right to manage their own property, have obtained freedom from unlimited liability Their personal assets will not be seized to cover the debts of the corporation which they own Such is the new concept of ownership under the corporate system

The management in the case of a corporation has to be separated from ownership for several reasons Firstly, the number of members of a company, who are the owners of the concern, is very large ' The idea that fifty thousand investors can express an

intelligent opinion about the conduct of corporate affairs in a changing *business world characterized by a rapidly fluctuating price* structure is an absurdity except for the rarest instances of emergency action "[1] Secondly, the members of a company are scattered over a very wide area as many companies have international membership Thirdly, the shares of a company are freely transferable and every transfer of shares involves a change in the membership of the company and consequently its policy of management Lastly, the complexities of modern business require separation of management from ownership since only experts are expected to manage the affairs of a large and complex business and shareholders are not expected to possess such *knowledge As a result, the very life of the company is almost* totally dependent upon the delegation of power to management

Instruments of ownership

Here it is proposed to describe the instruments which evidence company ownership "The proprietorship interest of the corporation is owned by the shareholders collectivelly, and their respective equities in the fund are called stock or shares "[2] "The capital stock of the corporation is sometimes defined as the aggregate ownership interest of the corporation This interest is divided into shares or units The stock certificate evidences the number of shares owned by a given stockholder "[3] The owner of a share is, in a sense, an entrepreneur , but ownership of stock is not ownership of the assets of the corporation , rather, ownership of stock is ownership of a contract with the corporation which, in turn, owns the assets Legally, a share is a contract, embodying rights and duties, between a legal entity, the corporation, and an owner of the share, the shareholder *When a share is purchased, the purchaser agrees to make full payment* for it In return the company gives the purchaser a bundle of rights, rights that are subject to limitations set forth in the share certificate, in the articles and the memorandum of association The right to manage may be partially restricted or completely abrogated, and the right to share in the earnings is subject to the discretion of the directors who declare them Moreover the shareholder may not share *in the assets which he contributes until the corporation* pays its creditors, surrenders its charter and goes out of business

Types of capital instruments

The property of the corporation arises from three sources Firstly, the contributions of those who promoted the corporation There is an understanding that these original contributions need

1 W H Husband and J C Dockeray, *Modern Corporation Finance*, 1957, p 239

2 L F Burtchett and C M Hicks *Corporation Finance*, 1948, p 87 The various terms used in connection *with the capital stock of a corporation are largely* the result of convention In England the terms 'shares' and 'shareholders' are popular , in United States, 'stock' and 'stockholders' are common India has adopted the English usage, but a distinction is made between the *share and the stock*

3 H G Guthmann and H E Dougall, *Corporate Financial Policy*, 1962, p 134

never be paid back, so long as the corporation has use for them, they represent a fund of capital with which the corporation carries on its business Secondly the capital is obtained on the express understanding that the money equivalent will be paid back at some future time—thirty days or a hundred years It is borrowed capital for which the corporation is specifically liable by contract There is a third kind of capital which comes into existence through the business activities of the enterprise i e corporation's own profits The right of profits accrues to the shareholders, the original contributors of capital Thus the property of the corporation is owned by the original contributors or subsequent creditors Accordingly capital instruments are of two types, representing (i) participation contracts or proprietorship securities, and (ii) debt contracts or creditorship securities according as the corporate funds are obtained by the sale of ownership securities or by selling debt securities In both the cases the corporation appeals to savers for the use of their funds. Financially, therefore, there is no much difference between ownership (equity) and debt contracts. Both the owner and the lender supply the corporation with funds, both seek to obtain income from their investments and both expect their principal to be returned to them. However, there are certain elements of distinction in the two type of contracts

A participation contract does not entitle the owner to a full return of his invested funds if the business is liquidated After all prior claims against the business are discharged, it entitles the contributor to his proportion whether or not this is considerably less than he actually invested Secondly, the contributor upon such a contract *is in no position to force a collection of a specific payment for the* use of his investment If any profits are disbursed, he may have a contractual right to share in such disbursement, but this right is predicated upon the existence of profits as well as on a decision of the directors to make a disbursement of such profits. If neither of these conditions exists, his capital may be utilized by the business for an indefinite period without a direct return to the investor. Thirdly, an investor in a participation contract is understood to have the privilege of engaging jointly in the management of the enterprise A shareholder has the right to vote in accordance with his share interest in the business

Debt contracts—Contrary to the right of a participation contract, in a debt contract a return of the sum originally invested is implied and may be enforced when due by a legal action against all of the assets in the business, including even the personal property of the enterprise Secondly, such a contract carries a right to have a specific payment annually or periodically for the use of the capital contributed to the business. This payment does not depend upon the existence of profits or the discretion of the manager Thirdly, the investor in a debt contract will not be understood to have any right to participate in the business decisions of the enterprise

The lender is satisfied with a lower return because his contract

gives him certain priorities, while the owner expects a greater return because he assumes the risks attendant upon a position junior to that of the lender Interest must be paid before dividends are paid on equity capital The loan is often secured by a mortgage, in any case the lender has a claim upon the assets of the corporation precedent to that of any stockholder

Thus, these variances in the capital instruments of a business create many legal relationships in its capital structure These instruments therefore must be recognized as devices to be printed, shaped, and changed to meet the particular conditions of a business and an investment market

Ownership security is also termed as equity security, equity *capital, or capital stock This is used to express the sum of values* received in the form of either money, property or services in exchange for the shares of a corporation This sum represents both the original and subsequent contributions of the shareholders The capital or capital stock of a corporation may consist of one class of shares or several, each with varying rights and liabilities Broadly, these rights lead to the division of shares into two categories

(1) Equity shares, and
(2) Preference shares

Section 85 (3) of the Indian Companies Act, 1956, permits the issue of only two types of shares, viz , (i) equity shares and (ii) preference shares Prior to the passing of the Act of 1956, the equity shares were termed as ordinary shares (and there was a third category known as 'deferred shares', popularly known as founders or management shares) The British terminology is similar to that in India, i e , ordinary shares and preference shares

In U S A , slightly different terms are popular For the word 'share', the common term in U S A is 'stock', for 'shareholder' it is 'stockholder' The chief classes of securities are (i) the common stock, and (ii) the preferred stock The terms ordinary share, equity *share and common stock represent identical meaning and have been* so used in this book Similarly, the terms preference share and preferred stock have also been used to indicate a single class of shares, the former representing Indian and British terminology and the latter the American practice

Common stock or ordinary shares

The best known, as well as the oldest, corporate instruments are the common stock or ordinary shares The Indian Companies *Act, 1956,* has renamed them as 'equity shares' No special privileges *ordinarily accrue to the holder of common stock* He enjoys the fundamental rights of shareholders The contract of ordinary stock is one existing between the holder of the security and the corporation which has issued it The agreement includes those provisions which the general law implies in the absence of any other agreement The shareholder is held to have given his consent to these terms by his

act of purchasing the share The *fundamental rights* of the shareholder include the following

(1) *To sell and transfer the share*

(2) To have an evidence of ownership of the share

(3) To inspect the books of the company

(4) To protect the corporation from wrongful acts of either majority or minority shareholders groups

(5) To restrain *ultra vires* acts of the corporation

(6) To participate in the management of the company, and to have a voice *in determining the policy of corporation on* questions which affect the corporation as a whole

(7) To participate in the earnings of the company

(8) To subscribe to new stock issues

(9) To share in the proceeds in the event of dissolution

Unless the contract between the corporation and the shareholder provides to the contrary, all shares are common or ordinary The financial position of the common stockholder is that of residual claimant, his equity acts as a shock-absorber' against shrinkage in assets of the corporation Unless otherwise provided, the voting power is vested exclusively in the common stock

Transfer of shares—One of the prime elements in the corporation as a form of business organization is the transferability of the ownership interests without directly affecting the enterprise Under section 82 of the Indian Companies Act the shares or other interest of any member in a company are movable property transferable in the manner provided by the articles of the company

Evidence of ownership—Every shareholder is entitled to recognition by the corporation of his ownership of the share This evidence of ownership is usually given in the form of a share certificate which may summarize the terms of the contract between the corporation and the share owner

Inspection of the books—A shareholder has the right to inspect the books of the company pertaining to the share records and general financial status

Protection of the corporation—In cases of oppression and mismanagement of the company, any shareholder has the right to apply to the Court for relief He can thereby safeguard the interests of the public, the corporation and his own The shareholders collectively have the right to appoint directors or to remove them

Ultra vires acts—The shareholders have the fundamental right to prevent the use of their corporate property for purposes for which it was not intended Every corporate charter states the purposes for which the stockholders contributed their money and to carry on this business only was the intent of the original stockholders and their successors, clearly expressed as the purpose for which they pooled their funds To use the property for other purposes is *ultra vires* Chief Justice Andrews of the Connecticut Supreme Court

observes "It seems to be the settled law of America and England, that any act, or proposed act, of a corporation or of the directors, or of a majority of the stockholders, which is not within the express or implied power of the charter of incorporation—in other words any *ultra vires* act—is a breach of the contract between the corporation and each of the stockholders, and that consequently any one or more of the stockholders may object thereto and compel the *corporation to observe the terms of the contract set forth in the charter* Directors are, therefore always careful to obtain their stockholders' approval for any changes in the character of the business for fear of third parties impeaching the legality of their action Nevertheless, *ultra vires* proceedings are an effective threat to prevent directors from using corporate property for ulterior ends

Participation in management—Ultimate authority to manage the affairs of the company lies in the hands of the shareholders The directors cannot proceed to sell or mortgage the entire assets of the concern without the consent of the shareholders The matter of voting power is *confidential* to the management of the corporation Generally speaking, this privilege of voting may be exercised at the annual meeting of the corporation upon two questions (i) the membership of the Board of Directors and (ii) the amendment of the bye-laws The shareholder has a fundamental and implicit right to elect the directors and also the right to surrender or restrict this right In other words, he directs the corporate affairs through his representatives unless he consents to surrender this right

Receipt of earnings—Among early corporations, the shareholders control over dividend disbursement was quite usual Such a reservation of power now is very unusual it runs counter to the generally accepted theory of the powers and responsibilities of directors Except in those unusual cases when a shareholder invests in corporate stock with a view to an increased value at a time of future sale, the shareholder regards his investment in the capital stock of a profit-seeking corporation as a source of income and he expects the profits of the corporation to be disbursed as dividends. Yet he has no right to receive these profits unless they are declared as dividends by the directors whose judgement in the matter is final

Subscription to new shares—Under the common law two important principles were laid down with respect to the old shareholders and new issues of shares (i) existing shareholders must be given an opportunity to retain their proportionate control in the affairs of the corporation and (ii) the equities of the existing shareholders in the surpluses of the corporation may not be impaired Both rules are violated if new shares are issued to the public before the existing shareholders have been offered the right to subscribe to them Suppose A held one-tenth of the shares of the corporation, which had 10 000 shares outstanding and should the corporation sell to others an additional 10 000 shares, A's control would be reduced by one-half Likewise, A's proportionate equity in any surplus which the corporation might have, would be reduced To

avoid this Section 81 of Indian Companies Act provides where it is proposed to increase the subscribed capital of the company by allotment of further shares then such further shares shall be offered to the persons who at the date of the offer are holders of the equity shares of the company *in proportion* as nearly as circumstances admit to the capital paid up on those shares at that date

Share in proceeds in dissolution Corporations leave the world as they enter it—possessed of nothing. They must distribute their assets to their shareholders after paying all debts Each shareholder is entitled in ordinary stock to share in proportion to the number of shares held by him out of the residual assets after all debts and other stock priorities have been discharged.

In the eye of the law the benefits that the shareholder may derive from his ownership of shares and the responsibilities which this ownership involves are represented by a contract Some of the rights which the shareholder enjoys by reason of this contract are clearly and explicitly stated *in the articles of association or in the bye laws* of the corporation other rights rest on certain provisions of the statute under which the corporation is chartered i e the Indian Companies Act Still other rights rest on the implications of stock ownership as interpreted by a long series of court decisions Roughly speaking these various rights may be grouped under three main categories (i) those concerning the shareholder s rights to *manage the affairs of the corporation* *(ii) those concerning his rights* to receive disbursements from the corporation and (iii) those rights to approve or estop any changes in the major provisions embodied in the original contract between the corporation and its shareholders These rights and privileges may be summarized as below

1 *Rights to management*
   (a) To elect directors (and to elect other officers)
   (b) To inspect certain books and to demand financial statements
2 *Rights to the corporate property*
   (a) To receive dividends
   (b) To receive a proportionate share of the corporate property when the corporation is wound up or its property sold or exchanged.
3 *Rights to change the original contract*
   (a) To pass on changes in the purposes for which the corporation was organized.
   (b) To pass on changes in the charter
   (c) To pass on changes in the bye laws
   (d) To subscribe on equal terms to all subsequent issues of shares

Advantages of financing with equity shares or common stock

Unlike other securities which are utilized primarily as a means

of raising capital, equity share or common stock has special and additional significance because of its rights of residual ownership of the corporation Preferred stock, no doubt, creates a form of ownership , but it is limited and not final or residual It is usually the nucleus of control and carries with it the familiar range of benefits and responsibilities which are ordinarily associated with ownership It is the first security to be issued by a corporation and the last to be retired in the event of liquidation The extremes of success or failure are the lot of common stock In the event of unusual profits it may be the beneficiary of extra or increased dividends , and in the case of failure it may suffer heavy loss

In many ways, common stock constitutes an ideal source of funds for the corporation The important reasons for this are

(1) *Absence of fixed payments*—In contrast to bonds or debentures—which require a recurring, fixed payment of interest, and repayment of principal either in instalments or by lump-sum maturity, irrespective of the financial status of a company—common stock makes it possible for management to exercise its discretion For example, if business is depressed and the earnings of a corporation are lowered materially sound financial policy may require declaration of dividends Default of interest on debentures or bonds would precipitate failure, but the omission of dividends has no such serious consequences As a result, shares provide a cushion of safety against temporary unfavourable developments

(2) *Improved credit standing*—Extensive use of common stock to raise capital also improves the credit position of the corporation Automatically, the enlargement of the residual equity increases the base of credit operation Unfortunately, weaker companies may not be able to sell common stock when they are in need of funds and may be compelled to resort to borrowing of some type Financial policy is often shaped by pressing expediency which permits little choice

(3) *More economic financing*—Sometimes it is cheaper to finance with common stock than with debentures or bonds Such a condition is normally the exception, but the opportunity may appear in periods of extreme boom or when there is public fear of inflation

(4) *A cushion of safety*—The common stock provides a cushion of safety against seasonal unfavourable developments, since the dividends are payable only out of the available profits of the company and the payment also is subject to the discretion of the directors

(5) *No charge on assets*—As against debentures or bonds, there is no charge against the assets of the company in the case of common stock This stock is available for further financing by way of security for borrowing

Disadvantages

These advantages of common stock financing are so noteworthy as to suggest its exclusive use as a source of funds However, there

are many reasons why common stock may not be used as the sole medium to raise capital In the first place equity shares are not always acceptable There is a large element in the investing group which will not buy equity shares either because of choice or because of legal restrictions Also equity shares may be acceptable to local interests and investors but may not be *saleable* in other sections where the management is not known under the circumstances, the debenture or bond possessing the proper legal protective provisions is desirable In the second place debentures usually sell at lower rates than share issues over a long period of time In the third place the issue of shares has a direct bearing upon control This is an intangible but an important determinant in the selection of new securities Fourthly the sale of more equity shares increases the base over which any future appreciation in value or increase in earnings must pe spread Fifthly, equity share has not much attraction to institutional investors who are interested in regular income rather than occasional abnormal profits Finally, excessive issue of common stock may result in over-capitalization of business

Par value stock and no-par stock

Value concept—Although the term 'value' has broad everyday use it has a wide range of meaning. Investors have a tendency to think that they may be purchasing shares for less than they are really worth and professional dealers on securities use the same idea for sales appeal Conversely, the feeling may exist that shares are selling for more than their worth In either case, this is the concept of *a basic or intrinsic value* The underlying thought of a static or moving norm has interesting and provocative facets , but at the same time, it is not subject to exact measurement To express in concrete terms, there are three concepts of value—*par* value, book value, and market value

Par value—Par value of a security is the value printed on the face of the certificate It is the unit value or denominational value It is an amount that is stated in the charter of the company for which a minimum figure is set All of the shares of a given class have the same par value Its significance lies in the rule that shares must not be issued for less than par, or else shareholders will be personally liable to creditors for any deficiency in the event of insolvency

The par value is distinguished from exchange value The former is static, while the latter is dynamic Business is dynamic in character, and values are changing constantly in response to gains and losses accruing to the business enterprise Large and increasing profits tend to increase the value of common stock , and, similarly, operating losses and other shrinkage of values produce an unfavourable effect Since par value is a constant figure, it must necessarily fail to register or reflect changing conditions

In American corporations, there are in use *three types of par value* for the share capital (1) *a high par value* representing the

money value of the shareholder's contribution to the corporation's capital It has a historical significance almost invariably issued up to 1912 The par was ordinarily $100, but $50 was not uncommon These were especially popular with banks and insurance companies, railroads, public utilities and older industrial corporations (ii) *No par value* for shares having no reference at all to shareholder's contribution, and indicating only his proportionate share in the profits and losses of the corporate enterprise and in the responsibilities of its management This type of share was preferred by corporations organized after 1919 , but again after 1930, the par value assumed greater significance (iii) *Low par value* for shares of $1 to $5, with the money equivalent arbitrarily made low, primarily to economize on taxes or to show on the balance sheet a larger surplus account Like no-par stock, it has little reference to the actual capital of the corporation

Book value The book value of a share or security is its worth as shown by the accounting records of the company It is the net worth as reported in the balance sheet When only one class of shares is outstanding, the book value is the sum of the capital stock and surplus accounts, and per-share book value is this total divided by the number of outstanding shares It seldom agrees with the market value, which reflects current investor opinion of the worth of the stock

Market value The market value of securities often differs considerably from book value, primarily because it reflects a varying evaluation of prospective earnings and dividends which the business is expected to produce as a going concern The most outstanding characteristic of a market is its realistic adjustment of prices in response to changing conditions , the market may not accept the value of the corporation as expressed in its books The market value of shares of a successful corporation is often in excess of the book figure Books of account ordinarily fail to record either possible or actual appreciation of values, and the market is dealing constantly in terms of the future outlook It follows therefore that the unsuccessful corporation will ordinarily have a book value in excess of its market worth , and a similar relationship is not unusual for companies with a heavy fixed-plant investment The reason is that the earnings lack the vigour to give buoyancy to the market , and it is likely that there is some discounting of the non-fluid condition of the assets

In brief, the concepts of value may be stated as follows

(1) Par value is a nominal figure and does not reflect the amount that a shareholder may actually realize, either in the event of sale or in the case of liquidation of the company

(2) Book value registers the effects of transactions on a cost basis, but it cannot be accepted as a yardstick of true worth

(3) Market value is the most reliable yardstick of the amount that a shareholder may realize upon his investment, but distinction should be made between short- and long term fluctuations in price.

Par value shares

The par value of share represents a sum which the corporation has fixed as the stated value of that stock. It is printed on the face of the stock certificate. Par value determines the legal liability of the shareholder to the corporation. If a subscriber pays less than par value, directors may at any time require additional payments until the full par value has been paid in.

The par value of each share is necessarily required to be paid into the corporation in either tangible or intangible property. Consequently the capital stock evidenced by the total number of shares multiplied by the par value, represents a fund of property which the corporation could claim as its own, and upon which it could *solicit credit* from outsiders.

The total par value of share outstanding represents the stated capital of the corporation. It cannot lawfully be impaired by the payment of dividends. The legal protection thus afforded by the stated capital of a corporation can be credited with the development of the so-called 'trust fund doctrine'. Creditors were willing to lend money to a corporation because there was a fund which would be protected and which they identified as security for their loans.

When par values are printed on stock certificates, it is common to express the dividend as a 'rate per annum' on the par value. Another characteristic which is ascribed to par value is its fixity. In contrast to the continually changing market and book values, the par value of stock cannot be changed. Under the theory that taxes should be levied in proportion to the benefits received from the state, par values may, assuming a benefit proportional to the capitalization of the corporation, serve as a basis of computing the tax. Thus par values are said to provide a measure of benefit represented by the corporation's right to do business. If a share subscriber fails to complete the payment for a share of par value, the presence of the par value provides an accurate basis for forfeiture on unpaid subscriptions. The net worth of the corporation normally consists of two divisions, an amount representing proceeds from sale of stock and another sum representing earnings of the business not yet paid out in dividends. Par value serves as a direct and facile method of distinguishing these two funds in the net worth.

Par value lacks significance

The par value lacks significance for the following reasons :

(i) *Shares may be issued for property at arbitrary values*—Par value may lack significance even at the time of issue of shares because shares may be issued for property as well as cash or even service. Property so acquired may actually be worth more or less than the amounts shown on the books at the time of its receipt.

(ii) *Par value may represent only a part of the shareholder's total payment*—Corporations, especially banks and some other financial concerns, may sell their shares for more than the par figure. In the case of banks, the resulting initial surplus can absorb early operating

losses that would otherwise mean an impairment of the legal capital and under the strict banking law might require an embarrassing assessment at a time when such a step might be fatal to prestige

(iii) *Retained earnings may add to or losses may reduce the original value of the stock*—Even if par value had represented the exact original investment of the shareholders, it would ordinarily cease to be a measure of current investment very soon because of earnings left in the business to add to the original investment There fore the rate of dividend when stated as per cent of par value is no measure of business success Shareholders may have much more than par invested either as a result of paid in or earned surplus so that a dividend rate of 10 per cent on par might be a very low rate upon actual investment as measured by the book value per share

(iv) *The market value of the business as an investment must always be the most important test of value rather than the nominal par figure*—Many businesses with par value fully contributed in cash at the outset develop so little earning power that the subsequent market value never reacts the original par On the other hand, when the business is able to earn from 20 to 30 per cent upon par, it is apparent that the market value will almost certainly exceed the par value even if that par value exactly represents the amount of actual cash investment in tangible property

Par value, therefore, is not to be regarded as a measure of the shareholder s investment because (a) the book value of assets that supports the par value initially may not equal the commercial or market value of those assets , (b) even when book value of the assets is a good measure of asset value, the total book value of the share rather than par value is the significant figure and (c) shareholders typically are more interested in the market value of their shares than in the book value

Other objections to par value shares may also be noted Par value is arbitrary artificial and static To accept par value as a measure of true value raises problems which it may be impossible to solve If, for example, two corporations were seeking to effect a merger or consolidation through the convenient device of an exchange of stock, they would find it difficult and probably impossible to match their shares on a par for par basis Additional equity financing is practically impossible when a company's stock is selling below par value Par stock tends to lull the investor into a false sense of certainty A fixed value engraved upon the share certificate leads those who are unfamiliar with book values and earning power values, to say nothing of security market fluctuations, to accept par values as real or intrinsic value Actually, the value of a shareholder's contribution hardly outlasts its payment into the corporation's treasury The value of one s share of a business, obtained by an initial contribution, is subject to immediate change as the result of the action of the management Par value shares are sold at either discount or a premium and this necessitates the use of an accounting artificiality Premiums should be added and discounts charged to the surplus account on the books of the corporation

No-par stock

The impetus for stock without par value originated in U S A from those who thought it desirable to remove par price tag from common stock and to emphasise its essential nature as a varying residual share in the ownership equity Then the unskilful would not be misled by drawing a parallel with the par value of a bond, which is the actual amount to be paid at maturity No-par was found as the only logical and reliable means of avoiding the liability attaching to par value This type of stock first became available with the enactment of a New York Statute in 1912 and today it is permitted in every state of United States

No par shares assumed importance during the decade 1920-30 In 1922 only 2% of the corporations were making use of no-par shares in America, in 1925, this number went up to 6% In 1928, all issues on the New York Stock Exchange, exclusive of railroad issues, showed that 43% were the no par units and by 1930 the use of no par shares had extended to 85% of the issues in companies with assets of 10 million dollars or more The no-par stock receded in importance after 1930 In 1956, out of 1,071 common stocks, listed on the New York Stock Exchange, only 239 (22%) were no-par shares, the number of par value shares was 647 (60%) and 186 were miscellaneous types of shares

In India, capital of a company initially is issued in the form of shares having a definite denominational or par value, but when the shares are fully paid up, the company can convert its shares into stock having no par value Section 95 of the Indian Companies Act empowers the company for such conversion or reconversion It may be noted that in America the term 'stock' is popular, while in India and Britain the term 'share' is in common use In India the term 'share' as defined under the Companies Act includes 'stock', and this resembles to a certain extent with the no par stock of America Of course, in India no par units (i e, stock) are of limited use, they are not so popular as the no-par stock is in U S A.

In America, there are two classes of securities which are called no par stock (i) *stated value* no par stock, and (ii) *true* no par stock In the first class no par stock is issued with a 'stated value' on it, that is with a minimum issue price, the stock being more or less a contradiction in terms The issuing corporation writes its value on the stock certificate It may be termed as the *face value no par stock* Such no par stock may be sold for any price (equal to or above the 'stated value'), the excess over the 'stated value is not necessarily a part of stated capital and may be used in payment of dividends It is properly a premium and corresponds to 'paid in' surplus or premium[1] on par value securities

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[1] In India a company can issue shares at a premium which is treated as a part of the paid up capital of the company, for all practical purposes it is termed as a new class of capital and cannot be distributed by way of dividends It can however, be used for writing off capital losses

With the second class, which may be called *true no-par stock*, there is no designation of value in any form Usually all proceeds derived from the sale of such true no par shares become a part of stated capital In those states in U S A , where the statutes are not specific, the presumption is that unless a specific provision was made at the time the stock was subscribed for, the whole of the subscription contract price would become stated capital and therefore would not be available for dividends All states at present allowing no par stocks permit stocks both of no-par value and of par value to be issued by the same corporation This is known as *mixed par values*

As the popularity of no-par shares increased in America during the twenties, considerable controversy arose as to the propriety of no-par feature with reformers taking the position that it should be made illegal The comparative advantages and disadvantages of *no par and par stock may be discussed from various standpoints* Sometimes certain characteristics may be an advantage from one standpoint and disadvantage from another We may take up four important points of view Those of (i) the corporation, (ii) the *shareholder, (iii) the creditors, and (iv) the public*

The point of view of the corporation

(i) *Avoidance of contingent liability*—No-par stock may be sold at any price and the liability does not extend beyond the initial figure It is adaptable to the prevailing market Having no stated value, it may be sold on the market for what it will bring, in accordance with the investor's estimation of its worth Succeeding issues may be sold at varying prices, prices determined by market conditions or the financial record of the corporation

(ii) *Avoidance of nominal value*—The use of no par avoids any possible friction of value resulting from the use of par Investors frequently err in accepting par as a norm or yardstick of the worth of shares Actually, investment value is completely unrelated to the par figure, which is purely nominal in character The value originally paid for no par stock, whatever it may be, is conclusive It removes the temptation and necessity for resorting to legal artifice

(iii) *Increased marketability of share issues*—No par stock permits flexibility in the setting of price and gives relief from the more static requirements existing under laws requiring par stock There is complete freedom for fixing a price that harmonizes with conditions prevailing in the market, rather than being limited by an arbitrary and rigid par established by a statute of many years' standing If there is great demand for stock selling in the $60 bracket, such stock may be issued , or if stocks at a lower figure are more popular, then the price may be set to attract this demand

(iv) *Accounting for capital stock*—The no par feature also permits greater flexibility in the treatment of the capital account

The net worth may be presented in the aggregate or may be apportioned between stock and surplus to reflect managerial policy Similarly, *there is greater ease in adjusting the capital structure to* recognize marked changes in the value of the assets The laws of no par stock require a minimum stated value in most cases, but these minimum requirements are nominal in character and do not represent any important restriction on accounting policy

(v) *Ease of management*—No-par stock issues are more easily managed than par value securities In the reorganization of a corporation old shareholders may ordinarily be handled more easily if no-par rather than par value securities have been issued The same is true in mergers and consolidation where the existence of par values may prove a stumbling block to the final consummation of the proposed combination

(vi) *Solution of financial difficulties* No-par stock is a solution of certain financial difficulties The legal rule prohibiting the sale of par value shares at less than par often prevents a corporation from obtaining additional capital at a time when it is most needed In the absence of no par stock, embarrassed corporations frequently avoid placing liability for uncollected subscriptions upon stock purchasers by means of the exchange of stock for some property The *property owner then returns, by way of gift, the extra stock to the* company , the returned stock is *treasury stock* and may be sold for any price to provide working capital or additional fixed capital, or used as a bonus to effect the sale of preferred stock The no-par stock presents an easy solution to avoid these difficulties

(vii) *Less objection of shareholders* When a corporation begins business, it is immaterial what price is received for the shares , but once it has begun operations, made profits, or suffered losses, it is obvious that the price at which additional shares are sold may materially affect the interests of existing shareholders If a bonus is given by the corporation, the no par stock may be issued for a very low price i e , for a small consideration

(viii) *Encouragement to investigate true value* No par stock encourages investors to investigate the true value of such shares before they purchase They need not be misled by the inscription of a fictitious value on their certificates Creditors also pay attention to the actual value of the corporate assets rather than the nominal value of the outstanding shares

(ix) *Easy finance* Financing through no-par issues permits corporations to carry out new equity financing with greater facility When a company needs capital, it may offer its shares, undeterred by an artificial par price , it can price them at the current market to get a ready sale Creditors also benefit from the ability of a company to market its equity issues without undue restriction

Disadvantages

(i) *Limited market* A great many purchasers of shares do not know how to determine the worth (book value or any other) of

a share and consequently are likely to show credence in the par value *printed on a certificate* Such purchasers may hesitate to accept no par stock , hence the corporation finds the market area of no-par stock somewhat limited

(ii) *Legal discrimination* Some of the states in U S A discriminate against corporations having no par stock, either through tax laws or by actual prohibition of power to do business Thus the area of operation of a corporation is considerably limited

(iii) *Difficulty of merger or consolidation* In the event of a merger or consolidation no-par stock of the new company is exchanged for the stock, of whatever kind, of the old companies All the stated capital as well as the surpluses of old companies will automatically become stated capital in the new company Such freezing of the surplus of the individual companies in the stated capital of the consolidated company is a difficult problem, since it considerably alters the position of shareholders in the old and new companies

(iv) *Effect on credit* Few par stocks carry any assessable liability, but credit is usually granted on a going basis instead of expectancy of liquidation The reduction of the liability of the shareholders is said to weaken the credit rating of the corporation because of the more limited protection to creditors

(v) *Aid to unscrupulous promotion* No par stock aids the unscrupulous promoter in selling securities because of the lessened liability as well as in facilitating the transfer of stock for his services and other intangible items

(vi) *Manipulation of accounts* The absence of a standard of value (par) makes it easy to transfer no par stock for promoters' services, on account of the flexibility in evaluating the capital account After operations are started, the surplus account may also be adjusted to conceal unfavourable conditions or to meet particular aims of management

The point of view of the shareholder

The essential distinction between the interests of the shareholder and those of the corporation is the difference between the interests of the individual and the interests of the group The benefits accruing to individual shareholders from no par stock are

(i) *Limited liability* The shareholder's liability is limited to his subscription agreement as long as the amount exceeds the legal minimum and is a fair market value It is reasonable having been fixed by the Board of Directors, or by a vote of the shareholders, or expressed in the articles of association

(ii) *Ease of investment by small shareholder* By the use of no-par stock, the corporation finds it easier to issue and sell additional stock to obtain new funds Under the circumstances, the shareholder with limited funds is less likely to suffer through the imposition of assessments at the hands of those having more financial backing and voting power

(iii) *Diligent enquiry* The absence of a par value on a share causes a prospective shareholder to make more diligent inquiry regarding the price of the share he proposes to purchase

(iv) *Dividend rate easy to understand* The individual shareholder can easily understand the dividend rate on no-par stock than on par value securities No-par stock always gives the number of dollars paid per share per annum whereas the statement that a \$50 par value stock is a 10% stock when it is selling for \$80 is likely to lead the unwary to believe that 10% refers to the market price rather than to the par value

The shareholder may find no-par stock undesirable to him for the following reasons

(a) *There may be over-valuation of purchased properties* patents, etc, or services of promoters when fully paid and non-assessable' no-par stock is exchanged for these assets or services, for when this is done the shareholder who buys for cash frequently pays *much more than* other shareholders (b) *It is easy to sell* greater amounts of no-par stock as compared with par value stock The position of shareholder, therefore, undergoes a radical change as compared to the circumstances under which he purchased the securities This change relates both to the extent of trading and the possibility of risk (c) If several issues of no-par stock are sold with equal rights, or if portions of the same issue are sold at different prices, any individual shareholder may find that he had paid quite a different amount for shares of the same kind. (d) The market price of no-par share is less stable as compared to par value share, because no-par stock is generally used for speculative types of business and because their dividend record is *thought to* be less stable

The point of view of creditors

The creditors of the corporation are interested in the no-par stock *for two important reasons Firstly, it has an influence upon* equity proprietorship, and secondly, shareholder's liability is relied upon as a reservoir from which the creditors satisfy their claims No-par stock easily qualifies as a favourable type of stock, since the corporation may dispose of such stock more easily and obtain large *initial capital or new additions to stated capital There is less incentive* for over valuation of assets to balance the books of the company or for the offsetting vice, inflation of organization expense to balance the books rather than showing a deficit at once The absence of par value encourages greater and more intensive investigation in regard to the standing of the corporation before an extension of credit is made

The creditors of a no-par stock corporation find themselves at a disadvantage for the following reasons (a) There is a general tendency to reduce the stated capital of the concern to the minimum possible (b) *There is considerable decrease in the liability of* shareholders The major characteristic of no-par stock corporations

has become, not limited liability, but no liability (c) As the corporate balance sheet merges stated capital and surplus into a single item, the creditor is at a loss to discover the actual amount of stated capital and thus increases credit charges on account of this uncertainty

The public point of view

No-par stock encourages speculative business enterprise and such enterprise is essential to progress in so far as it represents technological advances Secondly, there is a potential educative value in no-par stock The removal of the pretended par value of corporate shares is one step in the direction of interpreting the economic significance of corporations to all classes of society

Preference shares

The term 'capital stock implies that every share is identical in its economic and legal status with every other share But there has been a steady tendency, extending back for many years, to create several classes of shares one or more of which should offer in outward appearance, at least, greater investment security than mere stock This tendency has arisen from the fundamental divergence in point of view between the corporation, as the seller of securities which purport to have an investment standing and the investor, as the buyer of them ' While corporation and investor meet on the common ground of being joint heirs in the success or the failure of the corporate enterprise, they are at opposite points of the compass in the division of the spoils Because of this divergence in fundamental points of view there has arisen a large variety of types of securities which represent an endeavour to effect a compromise between the parsimony of the corporation and the avarice of the investor "[1] There are securities in which the investor relinquishes something of his rights as an unrestricted participant in the corporate profits and acquires a prior right to a limited but seemingly assured part in these profits , or there are securities in which he foregoes something of the security of a mortgage bond and obtains, in consideration of his forbearance, a higher promised income return They are compromise securities

The term 'preferred or 'preference as used in conjunction with stock or shares, means that the particular share or stock stands *in a distinctive and favoured position with respect to some of the usual* rights of shareholders There are ten of these more important rights subdivided into two sections (1) those rights wherein the preference shareholder ordinarily stands in the same position as the holder of ordinary share, and (2) those rights in one or more of which the preference shareholder occupies a distinctive position as compared to the holder of common stock or ordinary share

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1 Arthur Stone Dewing, *The Financial Policy of Corporations*, vol I 1941, p 133

(*a*) Rights usually not differentiated in preference shares

1 To transfer the stock
2 To have evidence of ownership
3 To inspect the books of the company
4 To protect the corporation from wrongful acts of either a majority or a minority
5 To restrain *ultra vires* acts of the corporation.

(*b*) Rights in which preferred shares stand in a different, usually a limited relation to the company as compared to common shares

1 To share in the proceeds in the event of dissolution
2 To participate in the earnings
3 To participate in the management of the company
4 To subscribe to new stock issues
5 To control future security issues injurious to original stock position

Preference shares usually possess a right of priority over ordinary shares as to dividends and as to principal in the event of liquidation Standing in a middle area between bonds and common stock, preferred stocks may have a great variety of adorning features. A share carries certain basic rights unless they are removed or qualified by the terms of the contract It is important therefore that the qualified rights of a particular issue be clearly stated. Some of these rights are set forth on the share certificate while others may be looked for in the Memorandum, the Articles or other evidence of corporate intent as to the preferential status of a particular issue

(1) Preference as to dividends

The most common and most important right granted to preference shares is the right to receive dividend before the ordinary shareholders A preference share *prima facie* only gives right to a preferential dividend and not to a preferential payment of the amount of the share out of the capital in the case of winding up Other rights have to be acquired by means of a specific provision in the articles. According to such a provision as to their preferential rights the preference shares may be of several types (a) cumulative (b) non-cumulative (c) participating (d) non participating.

Non-cumulative or simple preference shares—These shares usually carry a preferential right only to a fixed dividend payable out of the profits of each year before the other shareholders receive anything. If there are no profits or inadequate profits in a particular year available for distribution the holders of these shares have to go without dividend or receive only a partial payment they have no claim upon the profits of subsequent years for dividends unpaid in former years. In the event of winding up of the company they are in the absence of any express provision entitled to share equally with other shareholders

Cumulative preference shares—Cumulative preference shares are those on which the fixed dividend accumulates until it is all paid, the arrears of any one year being carried forward as a charge upon the subsequent year's profits There is, however, no obligation on the part of the company to pay until there are sufficient profits available for distribution Preference shareholders are not entitled to any arrears of dividend in liquidation if such dividends have not been declared, unless the articles provide otherwise Preference shares are always cumulative as to dividend but not preferential as to capital, unless the contrary is provided for in the articles, or the terms of issue of those shares

Participating preference shares—These are a class of preference shares, the holders of which are not duly entitled to a fixed rate of dividend in preference to other classes of shares but, in addition, are entitled to share, with the ordinary shareholders, the balance of profits in some proportion after the rights of the ordinary shareholders have been reasonably met The holders of 6% participating preference shares, for instance, may be entitled to share equally with the holders of ordinary shares in the profits remaining after the payment of 10% dividend on ordinary shares or they may be entitled to an additional one per cent dividend for every additional 2% over a specified rate on ordinary shares Thus, in the case of these shares they have two kinds of dividend—one fixed and the other changing, governed by the magnitude of excess profits If the articles are silent, all preference shares are deemed to be non-participating

Non-participating—If no participating rights are given to preference shares, they are entitled to the fixed rate of dividend in preference to other class of shares and no claim exists in the surplus profits which all go to the ordinary shareholders

(2) Asset preferences

To give the preference shares of a company preference to assets as well as to dividends gives added safety to the investor and at the same time makes it possible for the company to raise more capital without selling debentures or additional ordinary shares Of course, all preference shares do not carry preference as to assets, but by far the majority do Unless otherwise stated in the contract, these shareholders participate equally in assets with ordinary shareholders upon the dissolution of the company Sometimes, however, preference shareholders are given this preferential right While the provision is important, experienced investors do not regard it as definitive , it becomes significant only upon dissolution, and investors do not buy shares in anticipation of dissolution Such protection, through added sacrifice of the ordinary shareholders, is theoretically designed to eliminate the temptation to wind up the affairs of the company through sale of its assets by those in control of the company's affairs

(3) Management participation

Those who manage the affairs of a company, exercise control

through voting power All shareholders have the right to vote Preference shares being a mixture of various rights and privileges obtained by the reservation of authority, have a wide variation in respect of voting power[1] Nevertheless the majority of preference shares carry the right to vote in the event of failure to meet prescribed standards of operation One circumstance which gives cause for voting is the omission of dividends A large number of American issues provide for the assumption of the right to vote as soon as two consecutive dividends are passed while others may require as many as four In India the preference shareholders assume voting right as soon as the dividend falls in arrears for an aggregate period of two years or for two consecutive years as the shares are cumulative or non-cumulative respectively Because of a minority position voting power may prove to be of little value unless it provides for the right to elect a specified proportion of the directors

Preference shareholders in India have a right to vote on those resolutions which directly affect their own rights, viz., any resolution for winding up the company or for the repayment or reduction of his share capital Cumulative preference shareholders are allowed to vote on all resolutions if at any time the dividend is in arrears for an aggregate period of two years and non-cumulative preference shareholders if the dividend is in arrears for two consecutive years or for an aggregate of three years comprised in six preceding years. The voting rights of preference shareholders cannot be disproportionate , they are in proportion to the paid up value of preference capital to equity capital of the company

(4) *Protection against dilution*

The creation of any prior or equal claim against the earnings or the assets of the company will operate to reduce the equity values of the preference shares The degree to which such dilution occurs is proportional to the number of shares issued with at least an equal claim against earnings or against assets In the event of the creation of prior claims, the dilution is proportionate to the ratio between (a) such prior claims, and (b) the excess protection by way of earnings on assets previously available to the preference shares and the degree of the prior claim. If the element of priority in preference shares is of any value, then the holder of such shares could and should be expected to demand a voice in the matter Some companies in America provide protection against dilution by stipulating that the creation of any claim against earnings or assets equal to or superior to the preference shares shall require the consent of the preference shareholders in whole or in part Thus the same protection is given to the preference shareholders as is often extended to bond holders If voting power is given to the preference shareholders,

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[1] An American study of 250 industrial preferred stock issues between 1944 and 1946 revealed that 30 issues contained permanent voting rights and 220 had temporary voting rights (W B Taylor *Financial Policies of Business Enter prise*, 1956, p 147

then mere consent of the directors may suffice for the issue of additional preference shares A typical example of the protection enjoyed by preference shareholders is found in an American company which requires the consent of two-thirds of both ordinary and preferred stock before any mortgage or lien may be placed upon the property of the company or upon a subsidiary Another company s preferred stock must have two-thirds consent to issue additional preferred stock other than in exchange for convertible bonds

It may be noted that the chief weakness of preference shares as investment securities lies in the ease with which an unscrupulous or improvident management may place bonds, notes and bank debts ahead of an already existing issue of preference shares sold originally on the assumption that there were no prior liens (The preference shareholders in a company are usually investors whose concern in the management is indirect) For this reason they are entitled to some measure of protection against the ill results of business policy for which they are only theoretically responsible The vitally important protection is that which safeguards them against the dissipation of the property of the business

(5) Retirement of preference shares

Restriction upon the issue of additional preference shares in the interests of greater safety of the preference and ordinary shareholders is a negative or preventive measure It seeks to prevent abuse of the preference privileges by circumvention There may be occasions when it will be desirable to reduce the number of preference shares outstanding over a period of time instead of merely preventing additional issues Many preference contracts carry a clause which stipulates that the company shall itself purchase and retire a certain number of preference shares Reduction of the preference shares may be compulsory under the terms the contract or it may be made voluntary The general propositions governing reduction in the amount of borrowed capital by sinking fund, etc , are applicable Required reduction of preference shares may be brought about through one of the three processes (a) direct redemption, (b) redemption through sinking fund operations, (c) conversion

Redemption—In America redemption is accomplished by the purchase of shares and cancellation of shares so purchased Cancellation actually retires and reduces the amount shown to be outstanding in the books of the company This is the protection against declining marketability of preference shares The majority of preference shares in America are callable at the option of the company Not only does optional redeemability permit a more flexible financing programme, but it provides an opportunity to use periods of easy credit and low money rates to escape from onerous terms Preference shares have a relatively high dividend rate and other attractive features which may at times prove to be undesirable to the management The redemption privilege offers a convenient means for the removal of these restrictions Since the exercise of the option is at

the discretion of the company, it may come at a time that is detrimental to the investors who hold shares. As a result the redemption price usually includes a premium and the shares are callable only at a figure above par, or above the original issue price in the case of no-par shares. Consequently a sinking fund may be required to make redemption both more certain and more systematic

The Indian law provides for such option to be exercised by a company by issuing redeemable preference shares or irredeemable ones In case the shares are redeemed out of profits of the company a 'Capital Redemption Reserve Account' is created for the purpose which serves as a sinking fund

Redeemable preference shares—A company if authorized by its articles issues redeemable preference shares. These are redeemable on such terms and in such manner as may be provided at the time of issue of these shares. They can be redeemed within a specified period either out of divisible profits of the company or out of the proceeds of a fresh issue only when they are fully paid up

Irredeemable preference shares—Shares which are not redeemable are termed as irredeemable ones.

Conversion—Convertibility affords an opportunity for the retirement of preference shares through their conversion into ordinary shares at the option of the shareholder In redemption option is exercised by the company, in coversion it is applied by the shareholder. The use of the privilege is naturally inviting when share prices rise and the share loses its appeal under adverse price movements. If the ordinary shares of a company become of unusual value, the shareholder may exercise his option by exchanging his preference shares for ordinary shares in accordance with the previously determined basis of exchange. Sometimes conversion privilege is for the purpose of simplifying the financial structure The attachment of conversion feature also makes the shares more marketable and brings a higher price as well. The shares with the privilege of conversion are termed as convertible ones.

Convertible or non-convertible preference shares—Convertible preference shares are those the holders of which are given the right of conversion into ordinary shares within a specified period or up to a specified date The preference shares without such right of conversion are termed as non-convertible ones.

Advantages of preference shares

Although preference shares entail to the company a higher cost than debentures and often impose various restraints on the freedom of future financing, yet the following advantages induce the company to raise capital through preference shares

A substitute for debentures—Financial position of a company may preclude the issue of high-grade debentures but may be satisfactory for the sale of preference shares. The earnings of a company may not be sufficiently stable to meet the fixed charges on

debentures, but the average return may justify the use of preference shares

Easy reorganization—Preference shares are convenient medium of satisfying junior debenture-holders' demands in reorganizing companies that have failed

Protection of control –Preference shares are not only a convenient alternative for the raising of capital, but may also be favoured for reasons of control They usually have limited voting rights but seldom have authority to vote on operating policies By using preference shares controlling interests may continue their positions without further investment

Investor's preference—Preference shares have a special appeal to those individual and institutional investors who want to go for a regular income Institutional investors such as insurance companies, trust companies and public corporations, are attracted to preference issues because higher yields can be obtained than upon debt securities and the risks of investment are apparently less than for ordinary shares Also individuals have evidenced a tendency to favour the imagined respectability of preference shares, in contrast to ordinary shares, and the higher yields, in contrast to debentures

They are an intermediary security between ordinary shares and debentures There are on the one hand investors of speculative nature preferring high yield ordinary shares and on the other the conservative ones preferring debentures Midway between the two are cautious type of investors who like to invest in preference shares Their chance of gain is limited , their chance of loss is unlimited

Increased rate of return—Preference shares carry a fixed rate of return and do not participate in increased earnings of the company They may therefore be issued in order to increase the rate of return on ordinary shares

A tool of marketability—While marketing the ordinary shares and debentures, the preference shares may be issued as bonus shares, using them thereby as a tool to enhance the marketability of other securities

Important medium of finance– Preference shares may be said to represent compromises between the corporation and the investor The security is a hybrid, because it combines the characteristics of both debt and equity securities As long as it appeals to both the issuer and the investor, it will remain an important medium of corporate financing Further, corporations sometimes may find it injudicious to mortgage their assets to raise additional capital by issue of debentures or the assets might have already been mortgaged , preference shares might provide a convenient and economical method of raising capital under such conditions

Other securities

In addition to ordinary and preference shares, there are other ownership securities also, viz , (1) classified stock, (2) deferred,

founders', or management shares (3) prior lien stock, (4) blank stock, (5) guaranteed stock, (6) debenture stock and (7) special stock.

Classified stock—Following the World War I, a new type of preference stock known as class A common stock was introduced in America. Several historical developments accounted for the introduction of this type of stock. During the 1920's many investors were anxious to share in the prosperity of that period but wished to obtain stocks that carried dividend preference over ordinary common stock. Bankers were willing to offer such stock. Management was glad to issue it because it gave the holder no special lien on assets, no voice in company control the stock was non voting. Most of them have been no-par stocks. The dividend rate has been higher than for most preferreds. Usually they are participating. Where corporations issue this class of stock the ordinary common stock is known as class B common stock.

Deferred shares—Founders shares, sometimes called promoters' or management shares and popularly known in India as deferred shares were issued in payment for promotional services. They used to be issued under the Indian Companies Act of 1913, but the Act of 1956 has abolished them. No company can issue deferred shares now. They were also issued to underwriters in consideration of commission due to them from the company. These shares have the right to claim dividend after the preference (fixed rate) and ordinary shares (reasonable rate) are paid. When the company was very prosperous, they got huge dividends but when the company earned less they got small profits. At dissolution, they were treated equally with ordinary shares. They, however, enjoyed greater voting rights to control management of the company.

Prior-lien stock—It is a form of preferred security achieving a position of priority by permission of the holders of other preferred stock which may be outstanding. It is issued under financial duress. In certain circumstances, existing security holders may find it expedient to make such a sacrifice. When new financing is difficult and outstanding security issues are in jeopardy, the sacrifice of priority of claim because of improved prospects may be sound policy.

Blank stock—Blank stock was issued in America in 1929 for the first time under conditions of depression. The articles of association need not describe such stock, directors are left free to offer it in series, the terms of which may differ with each series. The directors are also authorized to stipulate the preferences, rights and liabilities of such stock. This security provides the corporation with flexibility in its financing since the directors are virtually given a blank cheque on the assets and earnings of the company.

Guaranteed stock—It is created in America whenever a corporation other than the issuing corporation guarantees the payment of the dividends upon an issue of stock. The guaranteeing corporation must pay the dividend or face receivership as insolvent. The stock-holder is placed in the position of being a creditor of the

guaranteeing corporation while retaining all his rights in the issuing corporation The guarantee usually arises through the lease of corporate property A holding company may guarantee the dividends on the subsidiary's common stock, instead of purchasing the securities of a subsidiary outright The implication is that the dividends will be paid even though an impairment of capital would result

Debenture stock—It is an English type of security and denotes an ordinary preferred stock and is more appropriately used to denote a bond issue where its nature can be ascertained only by reading the indenture

Special stock—A special stock denotes uncommon characteristics not fitting in any classification

APPENDIX

The Tata Iron and Steel Company Limited

A Note on Conversion of 48,750 Deferred Shares of Rs. 30 each into Ordinary Shares

The Tariff Board in 1949, in reporting on the steel industry, had recommended the abolition of the Deferred shares of the Company. Soon after the Company negotiated with Government for a loan of Rs. 34 crores to meet the cost of replacements and expansion of the company's plant when Government pressed the company for the conversion of Deferred shares into Ordinary shares. In the absence of a favourable response from the shareholders, the question was referred for opinion to an independent person of high status, Mr Motilal C Setalvad, Attorney-General for India, as Mediator. The Company agreed to meet the costs of the mediation. A technical expert was appointed to advise the Mediator on engineering questions relating to the productivity and valuation of the plant and an Accountant to assist him in accounting matters. The two classes of shareholders also appointed their own Action Committees and submitted elaborate statements and counter-statements in support of their respective view points and to controvert the statements of the other class. In both sets of statements, the need for conversion was accepted and the only question which was canvassed was the actual valuation of the Deferred shares in terms of Ordinary shares.

Several meetings were held before the Mediator in which the parties were represented by Counsel, Solicitors and Accountants and a full and fair hearing was given to the parties. On the 10th May, 1953, Mr Setalvad gave his opinion in which he fixed the ratio of conversion at 6 Ordinary shares for 1 Deferred share

The general effect of the conversion scheme was claimed as follows

(a) With the cancellation of the Deferred shares, the special features relating to dividend and distribution of surplus capital on a winding up was to disappear

(b) In their place, the Deferred shareholders would get for each 1 Deferred share held before conversion 6 Ordinary shares with a consequent sixfold increase in their voting power and a dividend equivalent to six times the dividend on Ordinary shares.

(c) On winding up they would be entitled to Rs. 75 per share in repayment of capital, as against Rs. 30 at that time and to share in all surplus assets along with other holders of Ordinary shares.

(d) If the scheme of conversion were in force earlier, the

higher dividend as follows should have accrued to Deferred shareholders

Year	Dividend to Ordinary shareholders	*Dividend to Deferred shareholders* Before conversion per share	Resulting from conversion per 6 Ordinary shares	Excess dividend available to Deferred shareholders
	Rs	Rs	Rs	Rs
1947-48	14	64 15 0	84	19 1 0
1948 49	14	64 15 0	84	19 1 0
1949-50	16	79 5 0	96	16 11 0
1950-51	18	93 10 5	108	14 5 7
1951-52	21	115 3 0	126	10 13 0

(e) The Deferred shares were a great hurdle in capitalizing the Company's reserves and the issue of bonus shares The conversion scheme, therefore, was taken up along with a scheme of bonus issue scheme It contemplated the distribution and allotment to holders of Ordinary shares, including Ordinary shares resulting from such conversion, of fully paid-up Ordinary shares in the ratio of 1 additional share of each share held Thus, the Deferred shareholders got, after conversion, 12 Ordinary shares for every Deferred share held by them (6 on conversion and 6 additional fully paid shares)

Scheme of Arrangement between the Company and Holders of Ordinary Shares and Holders of Deferred Shares in the Capital of the Company under Section 153 of the Indian Companies Act

1 The Capital of the Company to be increased from Rs 10,52,12,500/- to Rs 17,38,75,000/- by the creation of 9,15,500 new Ordinary shares of Rs 75/ each ranking as regards dividend, capital, voting rights and in all other respects *pari passu* with the existing 3,50,000 Ordinary shares which have been issued and are fully paid up

2 The holders of the 48,750 Deferred shares in the capital of the Company which have been issued and are fully paid up shall for and in lieu of each Deferred share held by them respectively, and in consideration of the extinguishment or modification (herein provided) of the existing rights and privileges attached thereto receive and become holders of six fully paid Ordinary shares in the Capital of the Company as follows

(i) 5⅜ Ordinary shares by capitalization of reserves and the distribution and allotment as fully paid up of Ordinary shares as provided by Clause 3 hereof , and

(ii) a further ⅝ of an Ordinary share under the reorganization and consolidation of the two classes of shares, Ordinary and Deferred, into one class of Ordinary shares as provided by Clause 4 hereof

3 A sum of Rs 2,04,75,000 - being part of the sum standing to the credit of the General Reserve Fund shall be capitalized and utilized for the payment and issue as fully paid up of 2 73 000 new Ordinary shares of Rs 75 - each The said 2 73 000 Ordinary shares, which shall rank for dividends voting rights and in all other respects *pari passu* with the existing Ordinary shares of the Company shall be distributed amongst and allotted as fully paid up to the holders of the said 48,750 Deferred shares in the capital of the Company in the proportion of 5⅗ Ordinary shares for each Deferred share held by such holders respectively on the footing that they become entitled thereto as capital

4 The 6,23 000 Ordinary shares (made up of 3,50,000 existing Ordinary shares and 2,73 000 new Ordinary shares) of Rs 75 - each and the said 48,750 Deferred shares of Rs 30 - each shall be reorganized and consolidated into one class of 6,42,500 Ordinary shares of Rs 75 - each (on the basis of the said 48,750 Deferred shares being replaced by 19,500 Ordinary shares at the rate of 2 5th of an Ordinary share of Rs 75 - for each Deferred share of Rs 30 -) and such reorganization and consolidation be effected by the extinguishment or modification of the special rights, privileges and conditions attached to the shares of the said two respective classes *inter se* (as set out in the Memorandum and Articles of Association of the Company) so that the said Ordinary shares and the said Deferred shares shall become and be regarded as forming one class of Ordinary shares ranking *pari passu* as regards dividends, voting rights and in all other respects

5 A further sum of Rs 4,81,87,500 - being part of the sum standing to the credit of the General Reserve Fund shall be capitalized and utilized for the payment and issue as fully paid, of further 6,42,500 new Ordinary shares of Rs 75/- each The said 6 42,500 new Ordinary shares which shall rank for dividends, voting rights and in all other respects *pari passu* with the 6,42 500 Ordinary shares of the Company resulting from the reorganization and consolidation referred to in Clause 4 hereof shall be distributed amongst and allotted as fully paid up to the holders of the said last mentioned 6,42,500 Ordinary shares in the proportion of one new Ordinary share for each Ordinary share held by such holders respectively on the footing that they become entitled thereto as capital

6 (a) Dividends on the said 48,750 Deferred shares shall cease to be payable as from the date this Scheme becomes effective in terms of Sec 153 (3) of the Indian Companies Act Notwithstanding that any such dividend shall relate to an accounts year of the Company terminating prior to such date

(b) The 9,35,000 new Ordinary shares made up of the 9,15,500 new Ordinary shares created and issued and allotted in terms of clauses 3 and 5 and the 19,500 new Ordinary shares resulting from the replacement of the existing Deferred shares on the reorganization

and consolidation of capital in terms of clause 4 shall be entitled to rank *pari passu* along with the existing 3,50,000 Ordinary shares for all dividends declared on or payable in respect of Ordinary shares after this Scheme becomes effective in terms of Sec 153 (3) of the Indian Companies Act as aforesaid notwithstanding that any such dividend shall relate to an accounts year of the Company terminating prior to such date

7 For the purpose of giving effect to the provisions of clauses 2, 3, 4 5 and 6 hereof the Directors may

(*a*) call in certificates of Deferred shares for cancellation and issue new certificates of Ordinary shares in exchange thereof and fix dates within which such exchange may be effected , and

(*b*) settle any question or difficulty whatsoever which may arise (including any question or difficulty arising in connection with any deceased or insolvent shareholder or any shareholder suffering from any disability)

8 The Company s Memorandum and Articles of Association shall be regarded as modified in accordance with this Scheme of Arrangement In particular the Articles of Association of the Company shall be deemed to be altered in manner following

(i) For Article 4 substitute the following Article

'4 The present Capital of the Company is Rs 17,38,75,000/- divided into 50 000 six per cent Cumulative Preference Shares of Rs 150/- each, 7 00,000 seven and half per cent Cumulative Second Preference Shares of Rs 100/- each and 12,85,000 Ordinary shares of Rs 75/- each '

(ii) In Article 82 for the words "Ordinary and/or Deferred Share" substitute the words "and Ordinary Share

(iii) For Article 140 substitute the following Article

"Subject to the provisions of these Articles and the terms of the Scheme of Arrangement sanctioned by the Court for conversion of the former Deferred shares of the Company into Ordinary shares, the profits of the Company which it shall from time to time be determined to divide in respect of any year or other period shall be applied first in paying the fixed cumulative preferential dividend at the rate of six per cent per annum on the capital paid up on the Preference shares to the close of such year or other period and secondly, in paying the fixed cumulative preferential dividend at the rate of seven-and-half per cent per annum on the capital paid up on the Second Preference shares to the close of such year or other period, and the balance of such profits shall be divisible among the holders of Ordinary shares in proportion to the amount of capital

paid up on the shares held by them respectively to the close of such year or other period "

9 This Scheme of Arrangement is conditional on

(*a*) the necessary resolutions (special or otherwise) for increase of capital and capitalization of reserves being duly passed ,

(*b*) the consent of the Government under the Capital Issues (Continuance of Control) Act, 1947, being given to the issues of capital provided under this Scheme of Arrangement , and

(*c*) the Scheme being agreed to by the requisite majorities of holders of Ordinary and Deferred shares respectively and sanctioned by the Court under Section 153 of the Indian Companies Act

Accordingly in the event of all or any of the above conditions (*a*), (*b*) and (*c*) not being fulfilled the Scheme shall become void

10 The Company may (by its Directors) assent to any modification or condition which the Court may think fit to approve or impose

3

Corporate Creditorship Securities

A corporation may raise capital in two ways (i) by taking the persons who furnish it into the enterprise as owners, and (ii) by making them creditors Those who become owners are known as the shareholders or stockholders and the capital they furnish is known as equity capital [1] The money that creditors furnish is known as borrowed capital The former serves as the base, while the latter is only subsidiary because without the permanent investment of equity capital by the share or stockholder it would not be possible for a corporation to borrow

Distinction between equity capital and borrowed capital

Financially, there seems to be no difference between equity capital and borrowed capital Both the owner and the lender supply the corporation with funds, both seek to obtain income from their investments and both expect their principal to be returned to them Legally, however, the distinction is clear Equity capital represents ownership capital, the proprietory interest Those who supply debt capital, on the other hand, are lenders The contract between the lender and the borrower provides that the borrower will pay the lender a specified rate of interest during the life of the loan and repay the principal at a specified time

The usual characteristics which distinguish equity capital (shares) from borrowed capital (debentures and bonds) are

(1) *Prior claim*—The lender's claim constitutes prior right which must be satisfied in full before anything can be paid to any shareholder

(2) *Interest a constant claim*—The interest owed to the lender is a constant claim which must be met regularly in order to avoid insolvency regardless of earnings or financial condition Dividends to shareholders are possible only when earnings warrant, and even then are paid only at the discretion of the Board of Directors Pay-

1 Charles W Gerstenberg, *Financial Organization and Management of Business* 1960 p 102

ment of interest upon debentures or bonds is therefore spoken of as a *fixed charge*, while the dividends paid upon shares are termed as *contingent charges*

(3) *Interest a fixed amount*—The interest on debentures or bonds is a claim for a fixed amount at a fixed rate, while payments to shareholders may or may not be a constant sum

(4) *Date of maturity*—Bonds and debentures have a definite maturity date upon which the fixed principal sum is repaid shares or stock have none

(5) *Right to a voice in management*—Debenture or bondholders ordinarily do not have voting rights and therefore have no voice in the management of the corporation , the shareholders have a voice in the management through their voting rights

Reasons for issue of bonds or debentures

A question obviously coming to the mind of an ordinary observer is why should a corporation prefer borrowing to raising funds by issue of shares A simple answer to this question is that it borrows when debt financing appears to be a more economical method of obtaining needed capital There are many other reasons as well The important ones are

(1) *Debt may be the only available source of funds*—Many small and medium sized businesses are so impermanent as to make permanent ownership investment risky and impractical for outsiders Such concerns may, however, own assets which would make a long term credit practical Institutions like life insurance companies and savings banks with plentiful funds for investment, may readily agree to lend when an ownership investment would be prohibitively risky If a small business lacks permanent assets suitable as a basis for long-term credit, it will have to depend upon short term credit, which will be renewed as long as the business seems able to assure ultimate repayment Similarly, when a government agency extends financial aid to a business unable to raise funds elsewhere, it takes a creditor s rather than an ownership position

(2) *Lower cost of funds*—Bonds or debentures represent less investment risk than shares In order to find buyers, a corporation may offer 4% interest on debentures or bonds, whereas its shares would have to hold out the hope of earnings of twice that amount In 1945, the usual earnings of different securities were bonds 2 87%, preferred stock 3 70% and common stock 4 1% This indicates that an investor accepts readily a lower annual payment on lendings than on shares The tax advantage of borrowing makes the real cost of debt financing lower than that of financing by sale of shares or retained earnings [1]

[1] There is the saving in corporate income tax in debt financing When a corporation incurs debt it only needs to earn a rupee over and above operating expenses to be able to pay a rupee of interest charges If shares are issued the corporation must earn enough to cover the amount payable to shareholders and the concomitant income taxes as well.

(3) *Investors' preference*—Only persons who can best afford to assume hazards and bear losses when they do occur should prefer investment in shares, while those of cautious nature and conservative temperament prefer to buy debentures or bonds Many major financial institutions, such as commercial banks, savings banks, and life insurance companies, do not invest any substantial part of their funds in shares because their major obligations are payable in a fixed number of rupees In U S A , the actual experience between the years 1929-47 goes to show that out of a period of 19 years in as many as 18 years (one single exception being 1929) a larger part of corporate financing was in the form of bonds (i e , borrowed capital) rather than in shares , the proportion in some of the years was

Year	*Percentage of total finance*	
	Stocks	*Bonds*
1932	4	96
1934	7	93
1935	7	93
1938	5	95
1941	11	89
1942	12	88
1943	16	84
1944	16	84
1945	21	79
1946	32	68
1947	24	76

(4) *To avoid sharing the voting privilege*—When a corporation issues new voting shares, the shareholders must increase their holdings in the ratio that the new share bears to the outstanding share if they wish to continue to wield the same proportion of voting strength Leading shareholders may find increased investment either undesirable or inopportune and so many prefer financing with debentures or bonds or non-voting preference shares It may be noted that the smaller the corporation and the more concentrated the holdings, the greater will be the concern over voting power Thus, to maintain control and still obtain outside funds a company may borrow rather than sell more voting shares

(5) *Trading on the equity*—To borrow at 5% and earn 8% is profitable financing for anyone This principle is known as 'trading on the equity' This means that the company gives the lender a claim against its equity, or net worth, in exchange for the use of 'cheap capital' The difference between what the company pays for borrowed funds and what it earns by employing those funds belongs to the equity holders The shareholder can enhance their total returns by trading on the equity This use of the credit of the corporation is an important reason for borrowing though only concerns with great stability in earnings should attempt it as a permanent policy

(6) *Broadened market for securities*—The use of debentures and bonds invites into the market the funds of persons not interested in acquiring ownership risks or responsibilities Likewise a concern can approach buyers of an area in which it is not well known with an offer of its bonds or debentures more readily than with its share agreements Thus funds have been drawn into the large scale enterprises of the eastern and central United States from the investments of all areas of the country resulting in good national distribution of funds

There are many other considerations in favour of debt capital Stable or rising commodity price levels engender business optimism and encourage borrowing. At such times the hazards of trading on the equity are discounted and debts are cheerfully assumed A corporation in need of funds attempts to obtain those funds from the cheapest possible source The use to which such funds are to be put determines the source For example, a corporation can borrow to finance the construction on the purchase of plant and equipment. Logically the loan would be secured by these assets and the duration of the loan would be related to the life of the assets Other specific purposes for borrowing include the consolidation of a variety of existing debts and the financing of mergers or consolidations

Classification of debt securities

The nomenclature of debt securities is different in different countries (i) In the United Kingdom and India the term *Debenture* is common but (ii) in the United States the popular term is *Bond* In the U S, however, sometimes a distinction is made between a bond and a note The term 'bond' refers to a long term debt, particularly one issued to the general public On the other hand, the term 'note' refers to a debt of comparatively short maturity having a limited number of holders Generally, in a note, the terms and provisions of the debt are set forth in the document itself, in a bond, they are found in a separate instrument known as an 'indenture' But in recent years, there has been a tendency to use the terms 'note' and 'bond' interchangeably

(i) Debentures

The word 'debenture' is derived from the Latin word *debere which means 'to owe People who used to supply provisions to the* royal household in ancient days, were given vouchers which were paid after sometime on presentation Thus a debenture is an acknowledgement of a debt, given under the seal of a company and containing a contract for the repayment of the principal sum at a specified date and for the payment of interest (usually half yearly) at a fixed rate per cent until the principal sum is repaid and it may or may not create a charge on the assets of the company as security for the loan

The Indian Companies Act does not define the term 'debenture' It simply states, "debenture includes debenture stock, bonds and any

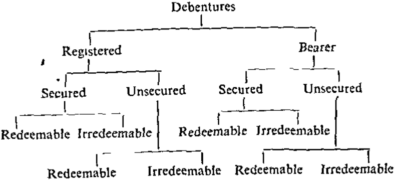
other securities of a company, whether constituting a charge on the assets of the company or not" [Sec 2(12)] The law includes debenture stock and debenture bonds in debentures, but the two terms are not identical They differ from each other, just as 'share' and 'stock' do *The difference is in form and not in substance* The debenture stock is borrowed money consolidated into one mass for the sake of convenience Each lender, instead of having a separate mortgage, has a certificate which entitles him to a share in one large loan. The issuing company mortgages property with the trustees *through a trust deed for the benefit of the holders of debenture stock* The certificates of debenture stock are not of any fixed amount They may be issued for any amount that is lent by an individual, e g, for Rs. 1,500 or Rs 200 (even if the value of a debenture may be Rs 500) Debenture stock is transferable in any fractional parts *unless the articles provide otherwise* and is payable only at the time of winding up of the company

On the other hand, a debenture bond denotes the description of an instrument and is transferable in its entirety and not in fractional parts It is payable at some specified time mentioned in *the instrument It is the most common form of taking long-term loans*

Classification of debentures

Debentures may be classified on the basis of (a) transferability, (b) security, and (c) redeemability

- (a) Transferability
  - (i) Registered Debentures
  - (ii) Bearer Debentures
- (b) Security
  - (i) Simple, Naked or Unsecured
  - (ii) Secured or Mortgaged
- (c) Redeemability
  - (i) Redeemable
  - (ii) Irredeemable



Registered as well as bearer debentures can both be secured and redeemable as also unsecured and irredeemable or even secured and irredeemable Thus, each debenture can have attributes of transferability, security and redeemability

Registered debentures—They are registered (entered) in the books of the company and are payable to the registered holders who cannot negotiate their holdings except in the manner laid down in the law The interest is also payable to the registered holder through the interest warrant The interest coupons are however negotiable

Bearer debentures—The debentures which are not registered in the books of the company and payable to the bearer thereof are called bearer debentures The interest due is paid to the holder irrespective of identity Coupons are frequently attached to such debentures for the payment of interest They are transferable by mere delivery There is no necessity of executing a transfer deed and registration in the books of the company and no stamp duty is payable on such transfer They are negotiable instruments and a person who acquires them for value in good faith and in due course gets a good title notwithstanding any defect in the title of the previous party He becomes a holder in due course

The holder of bearer debenture has the option to get his name registered in the books of the company on payment of a nominal fee He can get his registration cancelled whenever he likes by putting an application therefor and on payment of cancellation fee After this the debenture gets its old status

Simple, naked or unsecured debentures—On such debentures no security is given to the lender for the payment of interest and repayment of capital Their holder ranks as ordinary creditor of the company in liquidation Such debentures are not very popular since nobody likes to put his capital to risk

Secured or mortgaged debentures—These debentures are secured by a charge on the assets of the company In case of default, the creditor can make good his loss from the assets charged The charge may be a fixed (specific) or a floating charge

Redeemable debentures—These are repayable after a stated period of time

Irredeemable debentures—These are not repayable during the life time of the company issuing them. They are also known as *perpetual debentures* When the company goes into liquidation, they become repayable They also become repayable in case of serious default on the part of the company viz., non payment of interest

The trustees for debentureholders—It is not possible for a company to grant a charge on its assets to individual creditors who are in thousands when the debentures are issued to the public since the debentureholders are scattered over long distances and as such cannot act as a single person It is impossible for the company to give each one of them custody of the title deeds of the mortgaged property To overcome this difficulty, the trustees for debenture

holders are appointed The company acknowledges its indebtedness to the trustees and conveys to them legal and equitable interest in its fixed and floating assets by way of security for the loan and it gives them custody of the relevant title deeds Thus, the debentures are secured by means of a Trust Deed[1] conveying the company's property to the trustees to be held in trust for the common benefit of all debentureholders If an event happens upon which the security becomes enforceable, the trustees are empowered to take action on behalf of all the debentureholders The chief functions of the trustees are

(1) To take charge of the documents of title investments, etc representing the security

(2) To ensure the maintenance of security in a right manner, e g , by the investment of any redemption fund

(3) To ascertain that conditions of issue of debentures are being complied with by the company

(4) To take necessary action on behalf of debentureholders to safeguard their interests and to enforce the security by the appointment of a receiver

(5) To sell the security without going to a court of law and act promptly and effectively

Advantages of debenture finance

Debentures serve as an important source of company finance and their importance in total finance of companies is growing day by day The chief advantages are

(1) It is easier to raise sufficient funds by means of a debenture issue as it is possible to tap the resources of the people of conservative nature who desire to get a fixed income without much risk The fixed interest on debentures must be paid every year by the company whether it earns any profit or not

(2) The fear, that if too many ownership securities are issued the rate of return on them may fall down, is removed, since the return on debentures is fixed leaving the rest for being shared by the shareholders

(3) The debenture issue reduces dependence of the company on uncertain sources of finance such as public deposits and commercial banks

(4) The debentures are a cheaper source of finance as the rate of interest on them is lower than that on short-term borrowings

(5) When prosperity disappears and hard times come, the company may not find it easy to pay a reasonable return to share holders, but it will be advisable to keep the capital structure low by issuing redeemable debentures The company can easily set apart every year a small part of its annual profit as a reserve for redemption of debentures The sinking fund so created may be used for the

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[1] Important clauses of a Trust Deed are given in the Appendix at the end of this chapter

redemption of debentures when the time comes and by reducing thereby the burden of interest gradually

(6) The company can raise finance by means of debentures without giving control in management of the company

(7) There is a certainty of finance for a specified period and the company can adjust its financial plan accordingly

(8) The debentures have a great market response during the period of depression

(9) A company might have taken several small loans at high rates of interest in the past These loans can be converted into a single issue at a lower rate of interest affecting a substantial saving thereby

(10) The debentures are a desirable source of finance for monopoly enterprises like railways tramways and electricity supply companies whose market credit is good and where debentures are readily saleable in the market on account of their earning power

Limitations of debenture finance

The use of debentures is a desirable method of long-term finance as it ensures economy, but it has its limitations also All companies cannot use debenture finance since a company must have sufficient tangible assets to offer as security before it can issue debentures It should also have regular earnings to pay debenture interest Other drawbacks of debentures are

(1) Debentures impose a great burden on the finances of the company since interest must be paid whether there is profit or not

(2) Being secured against the assets of the company, debentures affect its credit in the market The result is that even banks which supply short-term finance to companies curtail their credit.

(3) If the business of a company is of speculative nature and its earnings are fluctuating from year to year, it should ordinarily issue no debentures, because constant interest payments weaken its financial position and become a danger to the very existence of the enterprise

(4) A company with a low proportion of fixed assets to total assets will not find itself in a favourable position to issue debentures as it has no sufficient security to offer to debentureholders

It is probably on account of these limitations that debentures in India are not very popular mode of corporate finance The reasons for their unpopularity are

(1) *No free market*—The market for debentures in India is limited The Indian investor generally cares more for safety of his investments rather than the income and prefers land and house property to industrial ventures Hence debentures with a fixed yield of interest and with no good prospects of capital appreciation do not attract him Institutional investors, such as banks, insurance companies and investment trusts, do not also like industrial debentures They prefer government securities as a better investment.

(2) *Heavy stamp duty*—The heavy stamp duty on their transfers restricts, to a certain extent, the creation of a free market in them

(3) *High denomination*—Debentures in India are of a very high denomination, usually of Rs 500 and Rs 1,000, and are thus beyond the means of the investor of moderate means

(4) *Attitude of banks*—A company which issues debentures finds its credit weakened in the eyes of the banks The banks think it as an indicator of weak financial position and look at it with disfavour The shares of a concern, which has issued debentures, cease to be acceptable as collateral security The reason for this attitude is obvious since debentures are a first charge on the assets of the company and it is supposed that the security for bank credit is necessarily less in the case of a company which have issued debentures

(5) *Terms not attractive*—There has been little variety in the types of debentures offered to the market and debentures with no special attractive terms do not find favour with the investor in India In other countries debentures are offered for sale in attractive and varied forms, such as guaranteed, redeemable on high premium, debentures having the right to appoint a few directors and to purchase ordinary shares at concessional rates, and so on The companies in India should follow a similar policy and should offer debentures on liberal terms

(6) *Government's fiscal policy*—The fiscal policy of the Government is also responsible for unpopularity of debentures to a certain extent The high excise duty, high taxation of profit and ineffective protection against foreign competition are other measures restricting the flow of capital into industry

(7) *Heavy expenses of issue*—The rate of interest on debentures in India is relatively high varying from 5% to 9% In addition, the initial legal charges and stamp duty and underwriting commission etc , make debenture issue very expensive and unattractive as a form of company finance

(8) *No advisory services*—There are no sound advisory services in India for the guidance of the public as in many western countries, except commercial banks and a few stock exchanges whose services are not available at all places

It may, however, be noted that with the expansion and development of the capital market in India, the debentures are likely to become more popular in future

(ii) Bonds (U.S.A.)

A corporate bond is a written promise, under seal, to pay a specified sum of money at a fixed time in the future, usually more than ten years after the promise is made, with interest at a fixed rate, payable at specified interest dates[1] The amount of the bond is

1 Charles W Gerstenberg, *Financial Organization and Management of Business*, 1960, p 104

ordinarily $ 1,000, although $ 500 bonds, $ 100 bonds, and even $ 50 bonds are becoming common

Usually a corporate bond is one of a number of similar bonds, all of which are covered by a so-called deed of trust that sets forth the obligations of the corporation and the rights of the bondholders The deed of trust is made out to a trustee who represents all of the bondholders, whoever and wherever they may be at any time

The more prominent features of a bond are

1 A definite promise to pay as to principal amount
2 A definite promise to pay as to interest
3 A definite life
4 A statement of the tender or medium of payment
5 The place of payment
6 Reference to the bond indenture for other rights and power such as limitations upon the issuance of additional securities, curtailment of management prerogative in the event of failure to meet prescribed conditions, action in the event of default of interest or principal payments, etc

***Parties to bond issue*.** There are three parties to a bond issue

1 The *corporation* wishing to borrow the money

2 The *trustee* through whom the corporation deals with the bondholder Because there may be many bondholders (when bonds are sold to the public) scattered widely, under the circumstances, it is not practical to deal with each of them individually, and the corporation appoints a third party as a trustee to represent the bondholders The corporation makes an agreement with the trustee or trust company which is variously called the "deed of trust", "trust agreement", "trust indenture", etc setting forth the obligations assumed by the corporation and the rights to be acquired by the bondholders

3 The *bondholders* who participate in the loan and who receive as evidence of their participation one or more bonds The contract between the corporation and the bondholders consists of the bond and the deed of trust

The trustee A corporation mortgage is a triangular agreement between the trustee, the bondholders, and the corporation The trustee is an agent of both the corporation and the bondholders. Although he is the agent of the bondholders, his appointment is made by the corporation long before any of the bonds are sold, and without consulting the bondholders

Any competent person may serve as trustee, but the usual practice is to appoint a company A corporate trustee has the advantage of continued life and serves with efficiency of a specialized occupation It is, however, customary to appoint a natural person in addition to the corporate trustee This dual trusteeship makes it possible to meet the requirements of those places in which the

corporate trustee is unable to act for the bondholders The trustee may be changed from time to time in the event of death or resignation, in keeping with provisions included in the underlying indenture

Duties of trustee—The primary duty of the trustee is to protect the interests of the bondholders The corporation is accountable to the trustee for neglect in its management of the property covered by the trust deed If the trustee fails to see that the corporation neglects to protect such property, the bondholders may have the trustee removed and a new trustee appointed The trustee is not a guarantor of the bonds He is, however, liable to the bondholders for the breach of his trust Thus a trustee who certifies bonds upon delivery of securities that do not satisfy the requirements of the trust deed may be held guilty of negligence A trustee who fails promptly to notify bondholders of the corporation's default may be held liable in damages to the bondholders

Among the more important duties of a trustee are

1 *Certification of the securities issued*—Before the bonds are issued, the trustee must authenticate them Authentication consists simply in signing a certificate usually found on the outside panel of the bond The authentication shows that no more bonds have been issued than are authorized in the indenture This certification is not a guarantee of the legal validity of the bond issue But the certificate does protect an innocent purchaser of the bonds, even if they are wrongfully sold or pledged by an officer of the company for his own benefit

2 *Checking of performance*—The trustee is usually required to examine the company's property and accounts from time to time to see that they meet the terms of the mortgage on indenture He must also check the existence of proper insurance, payment of taxes, etc The trustee must see that the corporation performs all its obligations under the indenture To enable it to do so, the trust deed usually gives the trustee the right to inspect the books and records of the company, and to request the corporation to furnish it with such information and statements as it needs for the purpose The trustee also receives copies of annual reports and of other information that must be filed with the Securities and Exchange Commission

3 *Action in default*—In the event of default in interest or principal payments, the trustee is expected to notify the bondholders and to take proper action against the mortgagor The trustee is permitted to take possession, obtain the appointment of a receiver, accelerate the maturity of the total debt, and bring suit to receive judgement in its own name against the corporation for the total amount of principal and interest due and unpaid The trustee is usually required by the indenture to exercise the care of a prudent man similarly situated in carrying out its duties, rights and obligations under the indenture The indenture may provide that not less than a majority of the bondholders may direct the time, method, and

place of conducting any proceeding for any remedy available to the trustee

Documents of bond issue Bond is a sort of contract between the issuing corporation and the bondholders There are several conditions governing the issue The conditions are laid down in a document and serve as the basis of the contract and protection to the bondholders In the United States of America, there are three such documents in use (1) Indenture, (2) Bond, and (3) Mortgage

(1) *The indenture*—One of the most important instruments relating to corporate financing in U S A is the indenture [1] An indenture is a contract or an agreement between the company, the trustee and the bondholders, which covers the terms and conditions pertaining to a bond issue It is usually called a 'mortgage indenture' when used in connection with securities supported by a mortgage, when used with unsecured obligations, it is generally known as a 'trust indenture', 'corporate indenture', or 'trust agreement' Besides including the duties of the trustee, it contains complete provisions having a bearing upon the bond issue As a result, the indenture is commonly as large as a book covering from fifty to several hundred pages, the existence and contents of which are known to but a few bondholders Seldom would any one be asked to read it Yet it is the source of bondholders' rights and the corporation's obligations The following summary of its contents may clear its nature and purpose

1 Preliminary recitals of the parties, authorization of the bonds, and the form of the bonds, interest coupons, registrations and trustee's certificate

2 Statement of the mortgage or deed of trust with a detailed description of the property security

3 Covenants of the company issuing the bonds to pay the principal and interest when due, to carry insurance and pay taxes, and usually to protect the bonds with such provisions as limitation of additional security issues according to the terms of the indenture, limitation on dividends on common stock in the event of failure to meet prescribed standards, etc

4 Provisions covering the sinking fund and the redemption of the bonds

5 Statement of the duties of the trustee

6 Definition of default and provisions for action by the trustee in this event

7 Miscellaneous provisions covering supplemental indentures, status of the bonds in the event of merger or consolidation, bond holders' meetings, etc

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[1] The word 'indenture' stemps from early times when agreements were written twice on a page in the original after which the page was torn and the separate pieces given to the parties involved If the indentations of the tear matched validity of the agreement was established

(2) *The bond*—The bond instrument itself merely contains a promise to pay a certain specific amount of the total debt with interest, and gives a summary of the main terms of the borrowing The bondholder must look to the indenture for the full details of the issue The bond is a negotiable instrument executed by the borrower, usually in the name of 'bearer This instrument then passes without registration, though by election a purchaser may choose to have a registered bond in his own name Each one of the bonds is a unit part of the whole loan, the full terms of which are contained in the indenture A bond issue without security would be complete with the creation of these two instruments (indenture and bond) Should the issue have an agreement for mortgage security, the indenture would describe the full terms of the mortgage also

(3) *The mortgage*—When it is desired to give security upon real or personal property as a grant of priority in payment to a creditor, a document in special form known as a mortgage is made In the case of corporate issues, this mortgage will be signed by the corporation and made over to the trustee of the bond issue as part of the indenture The trustee becomes the legal holder of the mortgage but on behalf of the equitable interests of the bondholders, this instrument is placed upon the public records in accordance with the filing requirements of each jurisdiction where any of the property is located

Classification of Bonds

Bonds are by far the most important mode of corporation finance in the U S A They have such a large variety of forms that it is almost impossible to arrive at an agreed classification They vary considerably in their terms and conditions Most issues combine so many different features that they may belong to more than one division of any classification which might be established In principle however, some sort of classification (grouping like with like and differentiating from the unlikes) may be found useful Although rigid classification is impossible, tentative groupings may be presented as an aid to study Broadly four bases have been adopted for the classification of bonds

1 The character of issuing authority
2 The character of the security
3 The purpose of the issue
4 The mode of payment of interest and principal

The following is a summarized version of a bond classification which has been widely used [1]

I According to the character of issuing corporation

A Civil loans—federal, state, municipal, etc , or

(i) United States Government bonds, (ii) State and

[1] William H Husband and James C Dockeray, *Modern Corporation Finance*, 1957 p 114

city securities (iii) Foreign government and municipal loans

B Corporate loans i e bonds of railroads public utilities industrials

II According to the character of the security of the bonds

A Unsecured Debenture bonds income bonds receivers certificates convertible bonds short term notes

B Secured or re-enforced

(i) Non property security assumed guaranteed joint bonds

(ii) Property security (a) Personal property (collateral trust equipment trust sinking fund bonds) (b) Real property (first mortgage general mortgage consolidated mortgage first and refunding mortgage first and consolidated mortgage bonds)

III According to the purpose of the issue

A. Civil (drainage school street etc)

B Corporation (improvement refunding purchase of equipment or plant consolidation etc.)

IV According to payment of interest and principal

A. Payment of interest (registered, coupon contingent etc)

B Payment of principal (collateral convertible serial sinking fund maturity etc.)

According to another authority [1] the bonds have been classified according to (i) the purpose of the issue (ii) the security of principal, (iii) the determination of interest (iv) the manner of payment of interest, and (v) the manner of payment of principal as follows

I *As to purpose*

1 Purchase Money Bonds.
2. Construction Extension and Improvement Bonds.
3 Funding and Refunding Bonds.
4 Consolidated Bonds
5 Adjustment Bonds.

II *As to security of principal*

1 Mortgage Bonds.
2. Bridge Dock, Divisional and Terminal Bonds.
3 Collateral Trust Bonds
4 Equipment Obligations
5 Debenture Bonds.

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[1] Gilbert Harold *An Outline of Corporation Finance*, 1950 pp. 59-64

6 Joint Bonds
7 Assumed, Guaranteed, Endorsed, and Stamped Bonds.
8 Receivers' Certificates

III *As to income*

1 Bonds of Definite Interest Rates
2 Income Bonds
3 Participating and Profit sharing Bonds
4 Stabilized Bonds
5 Tax Free Bonds

IV *As to the manner of payment of interest*

1 Registered Bonds
2 Coupon Bonds
3 Registered Coupon Bonds
4 Interchangeable Bonds

V *As to the manner of payment of principal*

1 Gold, Silver and Legal Tender Bonds
2 Stabilized Bonds
3 Redeemable or Callable Bonds
4 Convertible Bonds
5 Extended Bonds
6 Sinking Fund Bonds
7 Serial Bonds
8 Perpetual Bonds

Purchase money bonds—These are bonds given in direct payment, either part or full, for property and having a lien on such property In almost all cases they constitute a first lien It should be noted that bonds sold to investors to obtain funds to purchase a property are not purchase money bonds, but are loan bonds

Construction, extension and improvement bonds—Bonds sold to investors to obtain funds for construction of some property are known as construction bonds Similarly those sold to obtain funds to make extensions or improvements are called extension and improvement bonds respectively If construction, extension and improvement bonds are given to the sellers of some property in direct payment therefor, they will be termed as Purchase Money Bonds

Funding and refunding bonds—Bonds issued to consolidate the unfunded debt or debts of a business are called funding bonds since the purpose is to fund all or part of the corporation s unfunded debt Similarly, bonds issued to obtain funds to pay off an existing funded debt are called refunding bonds The corporation may sell its refunding bonds to new investors, or it may offer the new bonds to the old bondholders in exchange for the old ones, or both The old

bondholders are under no obligation to accept the refunding bonds as payment

Consolidated bonds—When a corporation has several issues outstanding on various properties, it may like to simplify its financial structure by the sale or exchange of a unifying 'blanket' or consolidated issue to replace the several smaller issues

Adjustment Bonds—These are issued at the time of reorganization of the corporation in order to adjust the obligations of the enterprise to a scale which it can carry They are usually junior mortgage or unsecured bonds and usually income bonds

Secured and Unsecured Bonds

While all bonds are supported by the general credit of the issuing corporation secured bonds have the added security of a preferred claim to a portion or all of the assets When a funded debt is secured by the pledge of specific property for the fulfilment of the obligation the debt is said to be secured When no specific property is pledged, the debt is said to be unsecured This distinction draws attention to the order in which claims will be paid and the legal remedies that are available to the bondholder In the case of secured bonds, the holder may foreclose against the property and force its sale when the mortgagor fails to live up to the provisions of the contract Unsecured bondholders, although they may sue to recover their claims like any other creditor, cannot foreclose upon specific corporate property and their bonds are said to be secured by the issuer's credit Unsecured bonds are, therefore, secured ultimately by the capacity of the company, and in particular the properties of the company, to produce an income Since the value of property is determined by its ability to earn, the real security behind any issue, whether it is secured or not, is the earning capacity of the debtor

In the event of non fulfilment of the contract, the secured bonds would have the following means of protection

(1) Prior claim to the property specified as security for the bonds

(2) In case this property failed to be of sufficient value to cover the face value of the bonds plus accrued interest, the bondholders would share equally with the unsecured creditors whatever is available to meet the balance of their claim

Thus, the benefits of specific security depend upon the value of the property pledged as security and the financial position of the corporation issuing the bonds

Corporate Mortgage

A secured bond is backed by the security of a specified property In the event of the failure of the debtor to meet his obligation the bondholder has to advance his claim against the property This has to be done according to the terms of the mortgage A corporation, like an individual, has the implied right to borrow or such a right is specifically

acquired by means of a provision in its charter But the right to dispose of the corporate property is different from that of an individual The company's shareholders are given the right to pass upon the sale of the assets Since corporations are chartered to perform a public function, the state reserves the right to approve any reduction in the properties assembled to perform that function Therefore, the earlier railroad charters contained clauses which granted the corporation the right to mortgage its assets , in the absence of such a grant, mortgage rights did not exist Today that right is widely granted to corporations by general or specific statute

The mortgage is defined as a "conveyance of an estate by way of pledge for the security of a debt, and to become void upon payment of it ' It is ' a deed (absolute in form, but subject to defeasance) given to secure the performance of some act upon the part of the mortgagor, usually his repayment of a loan made by the mortgagee at the time of the execution and delivery of the mortgage " The property pledged includes land, buildings, and equipment, or the bulk of the fixed assets used in operations The assets like cash, inventories, or receivables, are so constantly used or transferred in operations that they are difficult to pledge or to be used as security, particularly for a long-term debt The most usual kind of movable property pledged is stocks and bonds, which form the security for collateral trust bonds

There are two principal parties to the contract, the mortgagor and the mortgagee The mortgagor is the borrower, whose property, as security for the loan, is deeded to the lender, known as the mortgagee Since it would be cumbersome and impractical to execute and deliver a mortgage on the corporation's property to each and every bondholder, and since the transfer of such mortgages each time a bond was sold by one bondholder to a new one would impair the marketability of the bonds, a trustee is usually appointed to hold the mortgage for all the bondholders Thus, there are usually *three parties to corporate mortgages* the *mortgagor* (the corporation) the *mortgagee* (the bondholders), and the *trustee* It is expressly provided in the deed that upon payment of the obligation the conveyance of title is nullified This privilege is known legally as the 'defeasance clause' From the standpoint of their basic elements, mortgages have *three main forms* (i) mortgage with defeasance clause which requires the aid of a court to foreclose upon default , (ii) mortgage with defeasance clause which vests the power in the mortgagee to sell the property upon default , (iii) deed of trust, which in the habendum clause sets out the conditions upon which the property was conveyed and gives to the trustee named in the deed power to sell the property upon default All the three types, while using different names to describe the parties, have the following *basic features* in one form or another

1 Identity of parties (names and residences of the mortgagor and mortgagee) and the date
2 Preamble or statement of the indebtedness secured

3 Granting clause.
4 Description of the property pledged.
5 The habendum (to have and to hold) clause
6 Defeasance clause, providing that the transfer shall be void upon payment of the indebtedness
7. Covenants of title and warranty
8 Covenants to pay taxes and to insure
9 Provision for accelerating maturity of debt on failure to pay instalments or interest when due or in case of breach of other covenants
10 Provisions relating to foreclosure and sale including sometimes a power to sell without resort to the courts
11 Release of dower and homestead rights.
12. Conclusion—signatures of parties, and of witnesses when required.
13 *Certificate of acknowledgement before a notary public or* other qualified authority

Large corporate mortgages contain these basic features but are noted for their length, usually 100 pages or longer. Actually, the mortgage is combined with the other provisions in the indenture. It is common to designate the instrument as a 'mortgage indenture'. The mortgage indenture is made a part of the security by a reference clause which appears in the bonds held by the investing public.

Types of mortgages—The basic characteristics lead to the classification of mortgages as follows

A According to priority of claims
 1 First, second, etc.
 2. Senior and junior
B According to the right to issue additional securities :
 1 Closed.
 2. Open-end.
C According to the scope of the property covered by the mortgage
 1 Specific.
 2. Blanket.
 3 Blanket with after acquired clause

Priority of claims If there is more than one mortgage on a piece of property, the first one recorded has the prior claim and is known as the *first mortgage*. The second one recorded is known as the *second mortgage* and is junior in standing to the first mortgage. The term 'junior claim' means that there are one or more claims having a higher or senior rank in relation to the junior lien. Suppose a piece of property has two outstanding mortgages against it : a first mortgage of Rs 50 000 and a second mortgage of Rs. 30 000. The former bears 5% interest and the latter 7 %. If default occurs in the

payment of interest on the second mortgage, causing thereby its holders to institute foreclosure proceedings, the court offers the property for sale which fetches Rs 60,000 After payment of court costs involved in the foreclosure, the first mortgage has prior claim to Rs 50,000 plus interest Any balance left will be paid to the holders of the second mortgage Such mortgages may also be designated to indicate priority of claims as *senior mortgages*, having prior claims and *junior mortgages* having subsequent liens From the point of view of the corporation, the terms 'senior' and 'junior' are preferable to the simpler terminology of 'first' and 'second' mortgages An outright second mortgage will lack sales appeal

Right to issue additional securities Sometimes the size of the issue is specified If the full amount of bonds under a given mortgage has been issued, the contract is said to be a closed or *closed-end mortgage* When no such limit is placed upon the amount that may be issued under the mortgage, it is an *open-end mortgage*

Open-end mortgage—The creation of numerous liens may be expensive to the corporation for two reasons first, a number of small issues will not enjoy the same marketability as a single large issue equal to their sum, a condition which will tend to decrease the attractiveness and increase the interest cost of the former over the latter, and second, the latter issues, being junior liens, may have to pay such a high rate of interest so as to raise the total cost of the borrowing above that required for a single large first mortgage issue When, however, a mortgage is 'closed, so that no further bonds may be created under that lien, a multiplicity of issues becomes inevitable for a growing business requiring long-term borrowed capital for its expansion Any later mortgage debt has to be a secondary lien to the closed mortgage on that property

The open end mortgage, a device created to meet this problem, permits successive issues, all secured by a single lien Bearing a common name, these issues are distinguished as series A bonds, series B bonds, and so on [1] Occasionally the series are distinguished by the year of issue or, less frequently, by the maturity date, as the series of 1960 or the series of 1975 The various series are issued at different times and may be unlike as to coupon rates, maturity dates, and other features such as sinking fund and call prices The open-end mortgage is particularly appropriate for the railroad or public utility, which regularly employs large sums of borrowed capital as it grows The mortgages are sometimes designated as *limited open end* and *unlimited open end* also Limited open-end mortgage contains a clause limiting the amount of bonds which may be issued If the stated otal is not issued immediately, the corporation is authorized to issue up to the stated limit as its needs or wishes dictate This provision is very common in blanket mortgages and refunding[2] mortgages

1 Word *series* in the title of a bond is the usual indication of an open end issue
2 Bonds issued to obtain funds to pay off an existing funded debt are called refunding bonds

Closed-end mortgage—When the full amount of bonds under a given mortgage has been issued, the contract is said to be a closed or closed-end mortgage. Under a closed mortgage, no future issues of bonds of similar rank under the same mortgage and secured by the same corporate property may be sold other than those of the initial issue. This restriction affords excellent protection to the investors but may place undesirable rigid limitations on the corporation's financing. It deprives the company of the flexibility in financing that the open-end mortgage provides. Subsequent issues will have only a secondary claim upon the pledged property and will therefore be less acceptable to the investor. Thus the closed-end provision favours the mortgage exclusively. The closed feature is a fairly common characteristic of the divisional or underlying mortgages of railroads in U S A

The effect is especially far-reaching where the mortgage also contains an after-acquired clause extending the lien to cover all additions to the company's property in the future as well as the property already owned. While methods exist for avoiding the after acquired clause they are not very satisfactory. After-acquired clauses destroy desirable flexibility in financing, which may be of benefit to both the corporation and the investor. Management may be unnecessarily restrained in undertaking profitable expansion. In turn, the investor may suffer where restrictions prevent improvement of earnings position.

Mortgages classified according to scope of lien. Not only is there a question as to whether or not the mortgage should cover property acquired in future, but in addition a decision must be made as to what extent the mortgage may cover the property currently owned and whether the mortgage should cover all or only a portion of the property. If other mortgages are outstanding, the new mortgage must necessarily give consideration to the existing liens. Allowing for the diverse circumstances which are found in business, mortgages may be conveniently classified according to the scope of their lien into *specific* and *blanket*. A specific mortgage grants a lien on a particular piece of property only, while a blanket mortgage covers all the property of the corporation. The term blanket mortgage was once applied to liens that covered several pieces of property usually that of different subsidiaries which had considerable autonomy and independence of operation. *The term general mortgage* was applied to liens on properties which were integrated and operated under a common management. Foreclosure and claim properties are the same under either mortgage, although legal action under the blanket mortgage would be more expensive since properties are under separate jurisdiction. Either mortgage is usually a junior issue because the separate plants or properties have been mortgaged before if not, they would be senior issues. They will become senior issues when underlying mortgages are retired by redemption or refunding.

After-acquired property clause—When a corporation pledges

all of its present property plus any that it may later acquire, but prior to the satisfaction (cancellation) of the mortgage, the after-acquired property clause is incorporated into the mortgage Obviously, this gives greater protection to the bondholder Property acquired in the ordinary way at a later time would automatically come under the terms of the existing mortgage

This clause is most logical when the privilege of debt expansion under an open end mortgage exists and there is less incentive to save out later acquired property as security for possible future financing This provision may also be used in a closed mortgage where the debt runs for a substantial period of time and it seems desirable to assure creditors against impairment in safety such as might occur if the business should build better located and more efficient plants that would reduce the value of the old property

Occasionally, however, where the open end privilege is limited to a specific maximum and that figure has been reached, the corporation is confronted with a lien that engulfs all new property but offers no means of financing it If borrowing becomes sufficiently desirable, the obstacle of the after acquired clause must be removed or else surmounted by indirection provided that a junior lien is impractical The usual methods of removal of the restrictions are (1) *Calling the bonds* where such a right is present The new issue would then be for an amount sufficiently large to cover the old bonds and the expenditures for expansion (2) *Use of a purchase money mortgage* wherein the title to the new property is reserved in the vendor either by conditional sale or by a lease arrangement and consequently escapes the force and effect of the after-acquired clause (3) *Merger or creation of a subsidiary company*, where the consolidation of different companies is feasible and desirable, the parent or merging company would not be bound by the restrictions on bond issues of the company taken over Similarly, a new subsidiary company may be organized and the bonds sold under its name (4) *By means of a lease*—the title would remain in the lessor, and any after acquired clause relating to the bonds of the lessee corporation would naturally be ineffective

Security for bonds. A bond may be secured by a claim, or a lien, on certain property of a corporation, or it may be unsecured and may be merely a general credit obligation, usually known as a debenture in the U S A Real property, which includes land buildings, and most equipment, or the bulk of the assets used in operations, is the most common property pledged for a bond issue *All bonds secured by real property are called mortgage bonds* Most other assets, such as cash, inventories, or receivables, are so constantly used or transferred in operating that they are difficult to pledge or use as security, particularly for a long-term debt The most usual kind of *personal, or movable property to be pledged is stocks and bonds, which form the security for collateral trust bonds* In the case of railroads, *the rolling stock is often used as security for a specialized form of instrument known as the equipment trust certificate.*

Mortgage bonds As already stated, all bonds secured by real property are called mortgage bonds Corporate mortgage bonds, thus, are evidences of the promise of the corporation to pay interest and principal, secured by *a lien* on specifically named real property Such bonds are always sold with a lien against real property The lien may be a ***first, second, third,*** or *even lesser* lien Some mortgage bonds are designated by the term *prior lien*, which indicates that the issue has a lien prior to that of some other issue

The term, 'first and consolidated , means that the issue is both first and consolidated one The term first consolidated' means only that the issue was the first to be consolidated

The term *general mortgage* refers to bonds secured by a general or blanket mortgage on all of the corporation's properties which are already subject to one or more underlying (prior) mortgages, or which may be encumbered by another lien

The term, first and general mortgage , means that the bonds have a first lien on some of the corporation s property and a general mortgage on the rest

Consolidated mortgage bonds are issued upon a mortgage or a number of mortgages with a claim against several properties *Refunding and General Mortgage Bonds* are issued mainly for refund ing purposes with a general mortgage as security The latter may consist of various lien positions and other miscellaneous forms of protection *Refunding and Improvement Bonds* are usually issued for the dual purpose of refunding a maturing issue and at the same time providing funds for expansion or improvement of the property *First and Refunding Bonds* are generally secured by a first mortgage, but a junior lien position may exist in part The main purpose is to refund maturing obligations , but it is common to raise additional funds at the same time in order to finance improvements and extensions

Collateral Trust Bonds

The bonds secured by *personal property* have two chief sub classes (1) the collateral trust bond, and (2) the equipment trust obligation When stocks or bonds are pledged to secure a bond issue, the securities are known as collateral trust bonds These bonds may be classified according to the pledged security (a) bonds or stocks, or both, of the issuing corporation , (b) bonds or stocks, or both, of a subsidiary corporation , (c) bonds or stocks, or both, of an independent corporation

Holding companies commonly pledge the bonds and stocks of their subsidiaries in order to borrow The borrower gathers together the collateral or securities which he wishes to pledge and deposits them with a trustee under a trust agreement similar in form and provisions to the corporate mortgage The trustee is empowered to issue bonds up to something less than 100% of the par value of the deposited collateral He is authorized to sell the collateral for the benefit of the bondholders should the company default upon

interest or principal payments The agreement may provide that the company may substitute other collateral for that held by the trustee Rigidly drawn agreements usually provide that the market value of the pledged collateral shall represent some stated percentage, say 110% of the outstanding obligations and that if collateral is withdrawn, a corresponding amount of the outstanding bonds must be reduced

The collateral behind the collateral trust bond does not directly represent the security for such an issue The underlying security consists of the assets of the corporation whose securities are pledged Even more fundamentally, it is the earning power of the basic assets which will determine whether the interest and principal of the collateral trust bond will be paid Finally it should be noted that the value of the collateral does not depend upon the market price of the pledged securities Only a small portion of the collateral could be sold at prevailing market prices if it became necessary to reimburse the creditors by such liquidation

In the event of any default upon the bonds so secured, the collateral is seized and sold As in the case of mortgage bonds secured by real property, any excess received upon the occasion of the sale goes back to the corporation to pay other creditors while any deficiency becomes a general unsecured claim Although title to the securities pledged is transferred to the trustee as long as the issuer of the collateral trust bond does not default the pledger corporation is entitled to the income from the collateral and to vote any pledged stock by means of proxies issued by the trustee

Although individual collateral trust issues may enjoy premier investment rank, their general investment repute as a class falls below that of mortgage bonds The corporation considering financing with collateral trust bonds should note the factors that determine the willingness of the investment market to buy such bonds Usually they are (1) expected income from the collateral (2) value of collateral, (3) general credit of debtor company and (4) protective provisions

Equipment Trust Bonds

Generally speaking, fixed property is preferable to personal (movable) property as security for a bond issue Fixed property offers a definite and permanent basis of support while personal property is so mobile that the specific property offered as security may easily disappear from among the assets of the corporation Personal property is easily moved has temporary life, and is being converted constantly into the goods or services that the corporation sells On the other hand, in time of failure, the ready movability of personal property may prove to be of advantage because it adds to the property's marketability

To be used as a basis for reasonably long term credit personal property must first have sufficient life to make a satisfactory lien possible Inventories, receivables, and other current assets do not

meet this qualification and are not adaptable as security for long-term corporate finance The requirement is filled excellently by rolling stock of railroads Possessing an average life of more than 20 years, and being indispensable to the railroads operations, it offers a substantial basis for financing Railroads in U S A have taken advantage of this condition and in December 1954 equipment obligation constituted 26% of their total long-term debt

An equipment obligation is a security issued with rolling stock or other equipment as collateral Railroad equipment ranks close to collateral (stocks and bonds) as the most popular form of personal property used to secure corporate borrowing. American oil companies purchase tank cars with the aid of the equipment trust certificate and American air transport companies finance new flying equipment by the use of the secured instalment financing device Thus the term 'equipment obligation has acquired popularity and refers to bonds or certificates having a lien against railroad equipment, such as freight and passenger cars locomotives, tank cars, etc There are many plans under which equipment obligations are issued Each of these plans has various deviations in detail, but in general they are outlined as (1) the lease plan ('Philadelphia Plan'), (2) the conditional sale plan ('New York Plan'), (3) the equipment mortgage plan, (4) the mortgage collateral plan, and (5) the preferred stock plan

When a railroad desires to purchase cars and locomotives, it arranges with a trustee, usually a trust company, to pay most of the purchase price, say 75%, to the manufacturer , the railroad itself pays the remainder Title to the rolling stock runs to the trustee from the manufacturer and remains with the trustee until the rail road has met its obligation in full The trustee issues trust certificates to investors Under terms of the trust agreement the railroad pays the trustee a sum equivalent to the annual interest and a stated instalment on the principal sufficient to provide for the serial redemption of the outstanding bonds Not until the final series of bonds has been paid does the railroad obtain title to the property In the meantime the railroad promises to keep the rolling stock insured and properly maintained.

Debenture Bonds

The term 'debenture' means 'debt', but financial practice in U S A has restricted it to include only those bonds which are not secured by any specific pledge of property , they have no lien on any specific property , they are general credit bonds. Such bonds are commonly said to be unsecured, but any property not otherwise pledged acts as security in the broad sense of the word for the debenture bondholders and other general creditors Some corporations issue debenture bonds because their assets are intangible and incapable of being mortgaged , if their earnings are sufficient and stable their debentures will be high grade Other corporations prefer to keep their assets free of mortgage obligations and thereby maintain

the flexibility of their debt structure. Some corporations, however, issue debenture bonds because their assets are already so heavily mortgaged that unsecured issues are the only instruments available to them. Since debenture bonds are general credit obligations they occupy a junior position to all mortgage bonds senior or junior, which may be outstanding. If a company defaults on the interest on its debentures and is forced through bankruptcy, the debenture holders are in the same position as the general creditors.

The debenture bond is a widely accepted mode of corporate financing. It appeals to the corporation because the absence of a specific lien gives greater freedom to management and permits the reservation of secured obligations for periods of emergency. In the event of default in interest or principal payments the bondholders are unable to bring foreclosure proceedings to have the property sold by the court. From the point of view of the investor the debenture bond has an appeal because, in the last analysis, the general credit or financial position of the corporation constitutes the only assured basis of safety, irrespective of the type of bond. Specific security is of little value if the property lacks earning power, and the extent to which earnings will cover the interest charges provides the real clue for investment guidance.

Guaranteed Bonds

When one corporation (or more than one) guarantees the bonds of another, which it may do for a variety of reasons (to strengthen the bonds of a subsidiary company to induce a company to enter into some contract etc.), the bonds are called guaranteed bonds. The guarantee may relate to the payment of interest or repayment of principal or both. It may be given when the issue is offered, a holding company may help one of its lesser known subsidiaries to market its bonds by guaranteeing that the interest and principal will be paid. Or a company may guarantee the issue of another company whose product the guarantor needs. Most often the guarantee arises out of a lease arrangement between lessee and lessor companies. Governments may also guarantee the obligations of private corporations in order to assist their expansion, so as to serve some primary community need which would otherwise go unserved.

Joint bonds—When two or more corporations jointly float an issue of bonds the certificates are known as joint bonds. They may be either secured or unsecured. They usually come into existence through the endeavours of two or more concerns to use certain facilities (such as railway terminals, bridges) jointly. Joint bonds are frequently guaranteed bonds. Sometimes the term 'joint bond' is used to mean a jointly guaranteed bond.

Assumed bonds—When one corporation acquires another it assumes the obligations of the one acquired. Bonds of the acquired corporation are known therefore as assumed bonds.

Receiver's certificates—When a corporation is insolvent, a creditor or group of creditors or even the corporation itself may ask

the court to appoint a receiver to administer its affairs until (1) the corporation is again solvent or (2) it is dissolved If the corporation is not to be dissolved, the receiver may need additional funds to rehabilitate the corporation's affairs Few investors would loan money to an insolvent concern Consequently, with the authority of the court, the receiver may issue obligations which are, in effect, short-term bonds which usually take precedence over existing claims They are called receiver s certificates Their seniority will be wherever the court designates, but is usually placed high enough to make the issue saleable Ordinarily, the proceeds from the issuance of receiver's certificates may not be used for fixed capital purposes but only as working capital They must ordinarily be retired (paid completely or refunded) before the expiration of the receivership, or the court must be satisfied that they will be paid off It is the duty of the receiver to see that the available assets of the corporation are applied, if necessary, for their payment These certificates, in fact, are not the obligation of the company but of the court As a result, receiver's certificates have a high rating and bear a low interest rate

Bond Retirement

Corporate bonded debt may be retired by payment in full at maturity or by earlier redemption, by conversion, or by gradual repayment over the years There are four popular methods by which corporations, on their own initiative, may extinguish their bonded indebtedness (1) payment at maturity, (2) redemption before maturity, (3) refunding, and (4) conversion

Payment at maturity—Payment at maturity ordinarily involves no very complex problems The debt becomes due and is paid The cost is ordinarily that which the corporation has accumulated and set aside for the purpose through the establishment of 'sinking funds' to assure payment at maturity The payment may also be made each year of some of the bonds of the issue This plan calls for the use of serial bonds

Redemption before maturity—Corporations have various reasons for redeeming bonds before maturity

(1) Investing the sinking fund
(2) Reduction of fixed charges
(3) Improvement of credit standing
(4) Refunding
(5) Refinancing
(6) Avoiding high interest rates
(7) Sale of property

Refunding—Refunding does not necessarily extinguish indebtedness, but it replaces one debt with another debt It, therefore, extinguishes the former debt as originally drawn Refunding is usually done either (a) because the company considers it profitable to continue the indebtedness, or (b) because the company is unable to meet the obligation

Conversion—Some bonds carry conversion clause This entitles the holders to convert their holdings into stock under the conditions and terms specified in the contract When bondholders do so they cease to be creditors of the corporation and become owners Thus a debt is extinguished without cash payment of the debt by the corporation, and the fixed charges are reduced

APPENDIX

Main Provisions of an Actual Trust Deed

Trust Deed

The Trust Deed will provide *inter alia* as follows

(1) Security

(a) Payment of principal and interest will be secured by a first fixed and specific charge on the Company's immovable properties and fixed plant and machinery and a floating charge on the whole of the undertaking and assets of the Company

(b) The Company shall, however, be at liberty to hypothecate, to pledge and create mortgages or charges over its raw materials, manufactured goods and goods in process of manufacture and book debts ranking in priority to the said floating charge to secure sums borrowed from Banks or obligations incurred in the ordinary course of business of the Company and for the purpose of carrying on the same but save as aforesaid and save as mentioned below the Company may not create any hypothecation, pledge, mortgage or charge over or permit any lien to arise or affect any part of its properties ranking in priority to or *pari passu* with the floating charge and or the fixed charge The existing hypothecation and any hypothecation supplemental thereto in favour of the National Overseas and Grindlays Bank Ltd. will take priority over the floating charge to be created by the Trust Deed

(c) In respect of leasehold property (if any) for which the consent of the landlord is required and in respect of land acquired for which the consent of the Government of India is required for the creation of the charge thereon but which has not been obtained when the Trust Deed is executed, the charge created by the Trust Deed will not be of immediate effect but will be postponed until such consent has been obtained

(d) The principal amount of the stock to be issued pursuant to the Trust Deed is limited to Rs. 1,50,00,000 - but the Company is to be at liberty from time to time to issue further stock ranking *pari passu* in point of security with (but not in priority to) the said Rs 1,50,00 000 - stock carrying such rights as to interest, redemption and otherwise as the directors of the Company may determine provided that .

(i) The amount outstanding of the stock and of any stock ranking *pari passu* therewith (including such further issues) shall not exceed 50 per cent of the value of the specifically mortgaged premises comprised in the Trust Deed as certified by the Company's Auditors

(ii) The average of the combined profits of the Company and its subsidiaries (if any) calculated before charging depreciation and taxes on income but after charging all expenses of working and management including maintenance and repairs, for the three financial years for which accounts have been audited last preceding the date of any such further issue was sufficient to cover twice the amount required to pay the aggregate of one year's interest and the contribution (if any) to the sinking fund on the total sum outstanding in respect of the stock and all stock ranking *pari passu* therewith, including any such further issues

(2) Redemption

(a) Such part of the stock as has not been previously purchased or redeemed will mature for payment at par plus accrued interest on the 1st January, 1971 The Company may redeem the whole or any part of the stock on the 1st January, 1956, or at any time thereafter at par plus accrued interest on giving three calendar month's notice to the stockholders in that behalf

(b) A Sinking Fund will be established, to which annual contributions will commence in 1961 with a contribution in respect of the calendar year ending 31st December, 1961 Such contributions will be payable only out of the distributable profits (as defined in the Trust Deed) of the Company's relevant financial year as certified by the Company's Auditors Where such profits exceed Rs 5,00,000/- it will be obligatory on the Company to contribute to the Fund a minimum of Rs 5,00 000/- but the amount by which any contribution exceeds Rs 5,00,000/- may be applied in reduction of the Company's obligations in any later year or years In a financial year in which the distributable profits are less than Rs 5,00,000/- the Company will be obliged, unless it exercises its right to apply any excess of a previous financial year, in reduction of such obligations, to carry the whole of such profits to the Sinking Fund, but it will be under no obligation to make up the amount by which such profits fall short of Rs 5,00,000/- in any subsequent financial year or out of any excess of a previous financial year The Fund may be utilized in the purchase of the stock in the market at a price not exceeding par plus accrued interest or may be invested in trustee securities or deposited with a bank until required for purposes of redemption Stock purchased or redeemed out of the Sinking Fund is not to be re-issued 'Financial Year' will be defined in the Trust Deed as meaning a period in respect of which any Profit and Loss Account of the Company laid or to be laid before it in annual general meeting is or is to be made up

(c) In addition to purchases out of the Sinking Fund the Company may at any time purchase any of the stock at a price not exceeding par plus accrued interest out of current profits

(3) Trustees

Included among various provisions designed to indemnify and limit the liability of the Trustees are the following

(a) *The Trustees shall not be bound to take any steps to ascertain whether any event has happened upon the happening of which the security constituted under the Trust Deed becomes enforceable or to give notice to any person of the execution thereof*

(b) The Trustees shall not be responsible for the money subscribed by applicants for the stock or any part thereof or be bound to see to the application thereof

(c) *The Trustees shall not be bound or concerned to examine* or enquire into nor be liable for any defect in or insufficiency of the Trust Deed or in the title of the Company to the mortgaged premises or any part thereof

(d) No Trustee shall be liable for anything whatever except a breach of trust fraudulently committed by such Trustee, provided nevertheless that nothing in any of the foregoing shall exempt a Trustee *from or indemnify him against any liability* for breach of trust where such Trustee has failed to show the degree of diligence and care required of him as a Trustee having regard to the provisions *of the Trust Deed conferring on him any powers, authorities* or discretions

(4) Additional Provisions

(a) The rights of stockholders *may be modified* or compromised by an extraordinary resolution passed at a meeting of the stockholders in accordance with the Trust Deed, a quorum for this *purpose being the holders present in person or by proxy* of a majority in value of the total amount of the stock then outstanding or, in the case of an adjourned meeting, those present and entitled to vote On a show *of hands, each stockholder present in person* will have one vote and on a poll, each stockholder present in person or by proxy (who need not himself be a stockholder) will have one vote *for each Rs 1,000/- of stock held by him*

(b) A register of the stock will be kept at the registered office of the Company and may be closed for any period not exceeding forty-five days in any year

(c) The stockholders will be entitled to their stock free from equities or cross claims by the Company against the original or any intermediate holder

(d) *The stock will be transferable in amounts and multiples of* Rs 1,000/-

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Promotion of Corporate Enterprises

In the life history of an industrial or business unit promotion is the first step It consists of the discovery of new business opportunities, investigations of their feasibility and profitability and subsequently the assembly and organization of properties, finances and managerial ability into an industrial or business unit capable of functioning properly in the economic environment just like a living organism In this sense promotion is an act of bringing into existence a new business unit for producing goods or services with a view to advancing the material well-being of the people

A new business unit may be promoted in an entirely new field of business activity based on some new invention or discovery or it may be promoted in an old field of business activity where a number of business units are already at work Sometimes small business units doing successful business are enlarged and turned into private or public companies and at other times several companies or corporations are fused into a big single unit to achieve certain well defined objectives like the attainment of higher efficiency or the elimination of wasteful competition These activities are also included in the sphere of promotion The work of extending and widening the activities of a business unit is also called promotion in the wider sense of the term

The work of promotion may be taken up by individuals, groups of persons or by organizations Ideas of establishing modest business units usually occur in the minds of hundreds and thousands of individual businessmen and they generally set up successful and prosperous businesses But as they take up the direction and management of the businesses promoted by them into their own hands and associate themselves permanently with those units, they cease to be promoters afterwards and become permanent business executives Some of them continue the work of promoting new units along with the management of older units simultaneously To the extent that they engage themselves in the work of promoting new units they continue to be promoters The names of persons like Henry Ford of United States of America are very well known throughout the

world but in a country like India there are several names which are now well known not only throughout the country but even outside One of the most outstanding names in our industrial history is the name of late Sri J N Tata who conceived the idea of starting an iron and steel works in India quite early in the eighties of the last century Sri J R D Tata and Sri G D Birla belong to the second generation of early Indian promoters but some other persons like Sri Ram Krishna Dalmia and Rai Bahadur Seth Gujarmal Modi achieved remarkable success as promoters of new enterprises in India in their own life time

In countries like the U S A several wealthy persons like Rockefeller Brothers organized themselves into firms with the express purpose of channelling equity capital into new business enterprises Such types of organizations along with the investment bankers usually render financial and other help in the early stages of promotion and can be considered as promoters only to that limited extent Examples of professional promoters like Mr Charles R. Flint were also found in the U S A Sometimes the firms of industrial consultants like engineers and lawyers have also undertaken the functions of a promoter to a limited extent In India the Managing Agents have played the most important role in company promotion Although there is no dearth of gifted individuals possessing imagination, organizing capacity, resources and business connections but in the modern industrial world they rarely work alone, usually they take up the work of promoting new enterprises in the company of other capitalists, financiers or technically qualified persons

The functions of the promoter are of great economic and social value In some cases he helps in creating a new service or product enabling the people to live more comfortably, in other cases he brings into existence new methods of producing goods and services at cheaper costs in comparison to earlier costs and thus helps the people to buy more of these goods and services to improve their standard of living When the promoter brings about a consolidation he improves the tone of the industrial system by removing a cause of wasteful competition

The promoter in performing unusually valuable services for the community *undertakes great risks* The fees paid to various expert consultancy services are generally very high in a country like the U S A These fees sometimes range between $10,000 to $15 000 In our own country the expenses incurred by the Tatas in investigating the possibilities of setting up successful iron and steel works amounted to a total figure of £ 35,000 or Rs 5,25,000 On several occasions during the course of investigations it appeared as if the scheme was doomed to failure In one of the cases a promoter in the U S A stated in a court of law that $50,000 were spent by him in investigating the feasibility of consolidating a number of independent plants and in obtaining options Sometimes the promoters are able to make huge profits in promoting big concerns but these gains cannot be considered excessive in the light of equally huge

risks taken by them Really speaking the promoter can be called the midwife of the business world attending to the birth of a new concern and as such he renders very valuable services to the society

Essentially *there are four steps in the promotion of a new company or corporation* (1) The discovery of the opportunity or idea, (2) *the investigation and analysis, (3) the assembling of the elements* of business and (4) financial planning Usually most of the writers reduce them to three Some writers treat the first two steps as one while others include financial planning under assembling because finance is one of the elements of business which have to be assembled by the promoter The reason for treating all the four steps separately is that they are all equally important and it is rather difficult to assign a secondary role to any one of them

(1) Discovery

The discovery of an opportunity to start a profitable business may be made in a number of ways In the early stages of industrialization numerous opportunities of utilizing unused natural resources to advantage were clearly visible to the trained eye of an experienced businessman without much effort It was exactly in these circumstances that the British businessmen promoted numerous business units in quick succession in diverse fields of economic activity There was almost a race to seize similar opportunities in the early industrial history of the United States of America which threw persons of exceptional ability like Cornegie, Rockefeller and Morgan into bold relief But in the later stages of industrial development most of the new opportunities of doing good business *are either discovered through the process of scientific* research or through the efforts of the persons of ability and imagination in trying to overcome the difficulties faced by them in the process of manufacture or in the process of marketing the goods The discoveries of the new methods of producing chemical dyes synthetic rubber, artificial fibres etc are the results of scientific research while the discovery of the new ideas for promoting big combinations or Departmental or Chain stores is the result of efforts to find means and ways to overcome the difficulties of wasteful competition or to find better and more efficient methods of distributing an enormous amount of goods created by the use of mass production methods Discovery of opportunities may sometimes be accidental also as has been the case with the discovery of certain minerals, gas or petroleum deposits Many times new ideas appear only as tiny specks on the horizon of the imagination of the promoter They have to be *developed amplified and given a proper shape so that they may be* scrutinized and tested Similarly, the new processes or methods discovered through scientific research have to pass through the laboratory and pilot commercial tests before they can be taken as the basis of promotion of a new business enterprise

(2) Investigation and analysis

This is the second step in promotion intended to determine the

practicability and the feasibility of the proposed business opportunity from the economic and financial point of view The new idea or opportunity may be investigated and analysed from the point of view of its two aspects—the non-financial and the financial

The *non financial aspect* comprises the problems of management, sources of material and labour supply, location, engineering and legal implications In case of heavy industries like iron and steel this aspect is of very great importance This can be illustrated by a brief reference to the main points of criticism contained in the techno-economic report of the American experts on the feasibility of the proposed Bokaro Steel Plant The experts have expressed the view that a '*wholly insufficient consideration was being given* to the raw materials aspect of the Bokaro Project", in their opinion "it will take two years or more to find long term solutions to the basic raw material problem' The experts were not satisfied with the arrangements for the supply of power and water and the adequacy of the transport system They emphasized that the priorities necessary to supply adequate power for Bokaro should be implemented and new generating capacities at points in the Damodar Valley Corporation system must be installed at least concurrently with the construction of the steel plant For water supply, according to the report, the key element was the construction of a dam and reservoir at Tenughat by the Damodar Valley Corporation According to the report "the adequacy of the transport system is far from assured and fulfilment of present plans for construction of track and supply of rolling stock is a pre-requisite for efficient and fully productive operation of Bokaro' With regard to the question of manpower the report observed that unless fully qualified Indian and American personnel could be supplied from the start "there would be grave risk that very costly equipment would be unproductively used or even damaged" According to the opinion of the experts, Bokaro would have to train its own labour force as the area had virtually no useful labour supply except in lowest categories, it was rural, remote and poorly served by transport facilities It was unattractive to the great majority of potential Indian employees and more so to Americans The report has suggested, therefore, the building of a nearby town including medical, recreational, educational and shopping facilities, transport to and from the plant and better access from the outside The report strongly recommends that Bokaro be placed under U S management for at least 10 years The experts hold the view that "the American management contract is a pre requisite to attaining 100 per cent capacity four years after starting and to maintaining the relatively small and efficient work force" From the report of the American experts it appears that the above mentioned non financial aspects of the project were not spot lighted in the earlier report of the consultants of the Government of India (Messrs Dastur) In the case of heavy industries the non financial aspects of the projects are of utmost importance as the ultimate financial success depends upon the soundness of these non financial aspects

and, therefore, they have to be investigated and analysed fully and with utmost care

The *financial aspect* comprises the computation and estimation of the gross revenue likely to be obtained through sales, the costs and expenses likely to be incurred in the process of production and distribution of the goods and services and the net revenue likely to be available after deducting the costs and expenses from gross revenues After estimating the net revenue the financial requirements of the project have to be worked out and on the basis of the net revenue and the total financial requirements the percentage of net returns on the total financial outlay required for the project have to be found out to determine whether the returns are attractive enough to induce the would-be investors to part with their funds in the existing financial and economic situation

Estimating the gross revenue. Several methods are used for this purpose but two of them seem to be more importont (i) Market analysis by sample or canvassing method, and (ii) Statistical analogy or comparison method In the first method sample sales of the new product like a baby food are tried in selected areas or localities to estimate the possibilities of sale of the new product or the territory may be canvassed by visiting the region and making a survey of business and other activities to estimate the market for the products or services of the new company The survey method is more useful for transport enterprises In the second method, a detailed study may be made of suitable number of existing enterprises operating in the region and the volume of sales and other data about these concerns may be carefully scrutinized and anlysed to determine the chances of success of the new enterprise Certain precautions are very necessary in using this method The study of a single concern may not be useful as the success of a particular unit may be the result of some special factors like the magnetic personality of the person who heads the orgnization Secondly, the analysis of the data obtained from the operations of firms established under different economic situations and circumstances may also not yield useful and helpful information Thirdly, an attempt to analyse the data from different stages of different concerns in place of using the data of all the stages of same concerns may also not give useful results For the successful use of the comparison method a scientific selection of the firms for comparison is very necessary so that average useful results may be obtained to form the basis of correct decisions The securing of advance contracts for the supply of the product or services of the new concern to the likely consumers in the region is also considered to be satisfactory method assessing the possibilities of the sale of the product of the new enterprise

Estimating the costs and expenses The term costs is mainly applied to the amounts spent in manufacturing the product , the term expenses is used to denote amounts spent on distribution of the product and the outlays on administration Costs and expenses may vary according to the volume of business or sales but once this

volume has been estimated on a reasonable business it may not be difficult to estimate the cost and expenses because the rates of most of the items like wages rents, per unit prices of raw materials, tax, insurance are fairly well known at a particular time in a particular region or at a particular point And with the help of these rates the total costs and expenses can be easily worked out by the simple statistical method of multiplying the units of a particular item required by the rate of that item When this has been done net revenue can be calculated by deducting the total of estimated costs and expenses of doing business from the estimated gross revenues

Estimating financial requirements. The financial requirements of the new business may be estimated under the following heads (1) Fixed assets or block (2) current assets, (3) preliminary expenses (4) cost of building up the business, and (5) the cost of financing

(1) *Fixed assets*—The requirements of fixed assets differ from business to business according to the nature of enterprise. For certain types of businesses like the iron and steel works or the railroads the fixed capital requirements are the heaviest, for certain other businesses dealing in the purchase or sale of goods manufactured by other producers or for financial institutions like banks the fixed capital requirements are almost negligible. Trading and financing enterprises can be started in hired building with a small amount of funds invested in furniture and other equipment. The requirements of fixed assets can be reduced in the beginning even for such enterprises as the iron and steel mills or electric plants by taking up initially only certain phases of the entire programme of setting up a complete plant The scale of operations may also be kept at a lower level in the beginning with the aim of increasing it by stages later on For example, the Bokaro Steel Plant is expected to be completed by the year 1977 The total cost of foreign exchange for all the three stages is estimated at about $ 900 million The first stage may be completed in about four years The cost of foreign exchange is likely to be about $ 500 million. Thus the financial requirements of fixed assets are estimated by taking into account the factors like the phases or stages of construction, the scale of operations etc. into account so that the heavy expenditure may be spread over a convenient period of time

(2) *Current assets*—*These assets include items like stocks of* materials, merchandise etc and cash for meeting current needs. The financial requirements are generally estimated on the basis of time required for putting the goods or services of the new venture on the market for the first time After that the funds begin to form a circuit flow

(3) *Preliminary expenses*—The financial requirements for these expenses are estimated mostly on the basis of funds required for meeting the promotional needs like the payment of fees to experts of various types, payment of legal charges, printing and office expenses etc.

(4) *Cost of building up business*—Most of the businesses started for the manufacture or production of commodities take some time to become profitable In the initial stages the revenue obtained is generally less than the cost and expenses of production These initial losses represent the cost of establishing the business and have to be met by the proprietors This point is illustrated by the report of American experts on the construction of the Bokaro Steel plant According to the report the plant would not be profitable in the first step when the production is due to total 1,400 000 metric tonnes, but would become profitable at the second step, four years after the start of operations when production would reach 2,500,000 metric tonnes The implication is that the plant would run at a loss for four years after the start of operations, i e , during these years the gross sale proceeds would be less than the costs and expenses of production

(5) *Cost of financing*—The total financial requirements of the business have to be obtained by the sale of securities of different types The preparation of securities, their advertisement and ultimate sale through brokers and other financial agencies involve considerable expenses in the form of brokerage, commission, underwriting charges etc All these expenses are included in the cost of financing

The total of all the funds required for all purposes from fixed assets to cost of financing constitutes the total financial requirements of the new business If the net revenue estimated earlier is sufficient to provide a reasonably good return comparable to the current rate of return from similar enterprises on the total finance required for the new unit the promoter can proceed with his plans with confidence to establish the proposed corporation

Checking up and verifying the investigations Usually this is done by the experts working on behalf of the financial interests invited to help in raising the necessary funds for the new enterprise The exact position of this step should be between assembling and financing but for the sake of convenience its discussion is usually taken up after investigation and analysis

The report of the original investigators is likely to suffer from a number of defects and drawbacks Probably for reasons of economy the promoter could not utilize the services of a competent investigator of some reputation or the investigator employed was not unbiased and disinterested On account of these weaknesses the report submitted by original investigators employed by the promoter has to be checked and verified by another set of experts on behalf of the financial interests Both financial and non-financial elements of the investigation report are required to be checked The case of Bokaro Steel Plant may be again cited here as an example The report submitted by Indian investigators was checked up by the experts appointed by the American Government This was considered necessary by the American Government before agreeing to provide financial assistance and it is important to note that a number of weaknesses pointed by the American experts have been accepted

by the Government of India and remedial measures to remove the weaknesses are being planned

There are two important methods of checking the investigation report The first method is really a thorough and critical examination of the report itself An experienced person in a given field of business is usually aware of the major weaknesses and difficulties and the crucial points on which success or failure is likely to depend are readily discerned by his trained eye from the report itself The second method of checking is the same statistical analogy or comparison method to which reference has been made earlier Published data for proportionate amounts invested in various classes of assets investment per unit of output or capacity unit costs of production etc for various industrial groups are usually found. Similar data for the proposed business may be compared with the published data of the groups of similar type of companies A great deal of care has to be taken in comparing such data because the published group data does not give any idea of a considerable amount of variation from unit to unit which may exist within the group or an industry

(3) Assembling the elements of business

This is the third step in promotion When the practicability and profitability of the business opportunity discovered by the promoter has been established by thorough investigations and analysis efforts may be made by the promoter to give a concrete shape to the idea conceived by him This is done by bringing together the various elements of business (1) idea or opportunities, (2) property, (3) personnel and managerial ability, and (4) finances Out of these elements the financial arrangements are to be treated under a separate independent heading

In the process of assembling, the idea or opportunity has, necessarily, to be brought to the knowledge of other parties interested in management, finance etc and in doing so the promoter has to take suitable steps to safeguard his own interests against piracy One of the steps suggested is to present the idea only to those who are known to be honest The other alternative is to take recourse to legal protective measures An opportunity like an invention, trade name or trade mark may be safeguarded by taking out a patent under the patent laws of the country Things like advertising matter may be copyrighted Opportunities like an idea of combining a certain number of existing plants may be protected by taking options, concessions or licences or by entering into binding contracts, although the difficulties of drawing up a binding agreement are sometimes said to be insuperable An American case (*Haskins vs. Ryan*) is cited as an example of this Haskins conceived the idea of combining a number of plants and took out options against their properties He disclosed his plans to Ryan who pretended to be interested in taking them up It was alleged that Ryan delayed matters up to the time of the expiry of the options taken out by Haskins and then proceeded with the consolidation himself To

avoid these situations, sometimes, the promoter has to undertake a part of the assembling job himself by taking up leases or other property rights in his own name or in the name of a firm or a board of trustees, to be transferred later on to the new company at an appropriate time After arranging for the procurement of property or the right to use the property the promoter has to obtain the consent of the persons well known for their managerial talent and ability to take the direction and management The willingness of able and reputed persons to accept the responsibilities of management makes the path of securing the financial assistance more smooth than it would have been otherwise When the assembling of elements of business has been done successfully the promoter has in hands what is usually called a "proposition' to be presented to the financiers

(4) Financial planning and financing

This is the last step in the promotion of a new business The "proposition' has to be presented to the financiers in a well organized form The reports of the investigators, accountants, engineers, market analysts along with the opinions of lawyers and other experts should be attached to the final draft of the "proposition" The promoter may, already be in touch with investment bankers, capitalists, underwriters, etc The parties interested in financing the new business will get the "proposition checked and verified by their own independent experts This procedure has already been discussed earlier When the financiers satisfy themselves about the soundness of the "proposition' on the basis of the reports of their own experts, a financial plan to suit the exigencies of the existing economic situation and environment is drawn up to secure the necessary funds , the necessary legal formalities of registration and the issue of prospectus are gone through , the securities are sold and proper organization to take over the newly promoted enterprise from the promoter is set up

The entire foregoing theoretical discussion may be illustrated on the practical plane by taking the example of the promotion of Tata Iron and Steel Company, Jamshedpur

(1) ***Discovery*** In 1882, while still working at Nagpur, supervising the Empress Mills Tata (late Mr J N Tata) chanced to see a document It was a report on the financial prospects of iron working in the Chanda district by Ritter Von Schwarz, a German expert, an employee of the Government of India This inspired Mr Tata to explore the possibilities of establishing an iron and steel works Thus the idea of starting an iron and steel works was conceived

(2) ***Investigations and analysis*** (a) *Preliminary investigations*—Tata is believed to have visited Lohara iron ores fields He also had the Warora coal analysed and at a later date he took specimens to England, where coking trials were made with no very satisfactory results After 1900, he took prospecting licences for Lohara and Pipalgaon deposits in Chanda district In 1902, he

again took samples of coal to England and had experiments made in Germany and America He personally went to Carlsbad and Dusseldorf in Germany in this connection

From England Tata sailed to America He visited *Burmingham* standing in the midst of an immensely rich iron coal and limestone region He met Mr Erskine Ramsay and other prominent manufacturers of iron and steel and the President of the Steel Trust At Pittsburg Mr Tata met Mr George Westinghouse and other industrial leaders and visited the Mills of the *Cornegie Steel Company* At Pittsburg Mr Tata discussed his plans with Mr Julian Kennedy, the Head of the firm of Messrs Julian Kennedy Sahlin & Co who advised Mr Tata to institute first a far more thorough and scientific investigation of the local conditions raw materials and the markets of India than he had hitherto done On the advice of Mr Kennedy, Mr Tata engaged the services of Mr Charles Page Perin, an eminent consulting engineer of New York

(b) *Detailed investigations*—Mr Perin first sent his associate Mr C M Weld who along with Messrs Dorabji Tata and Saklatwala entered upon a period of adventurous wanderings in C P (*now Madhya Pradesh) in April 1903* Mr Weld *travelled* widely in the region examining the prospects of the supply of iron ore coal and water At the end of his enquiries, very reluctantly, he came to the conclusion that the Chanda project must be given up

On their return to Nagpur the prospectors came to know about the ores of the Drug district Without losing time Mr Weld visited the Dhalli and Rajhara hills and was fully satisfied Tatas at once obtained a licence and borings with diamond drills were made on an extensive scale in Rajhara Hill under Mr Weld s supervision. The results were highly satisfactory A rough analysis of the samples showed *an iron content of* $65\frac{1}{2}\%$ Mr *Perin also reached India* and declared these ores as one of the mineral wonders of the world. Mr Weld carried out a long and careful survey of the Jharia and Raniganj coalfields and found that suitable coking coal could be obtained from Jharia only Samples of Dhalli and Rajhara ores and Jharia coal were sent to Germany and America and the trials were declared to be successful The problem of large and constant water supply led the Tatas out of C P (now Madhya Pradesh) to a site on river Mahanadi near Sambhalpur at Padampur [1]

At this stage the Mayurbhanj ores were brought to the notice of the Tatas by Mr P N Bose Messrs *Dorabji Tata* Weld, Perin and Saklatwala visited the Gorumahisani Hills in Mayurbhanj State (Orissa) They found that these hills formed enormous deposits of iron ore quite as extensive as those at Dhalli and Rajhara not so compact and not quite so rich but more favourably situated The ores were nearer the sea and nearer the coalfields of Bengal The firm entered into an agreement with the Maharaja of Mayurbhanj

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1 Dhalli and Rajhara ores now support the Bhilai steel plant and the Rourkela plant is now located a little north of Sambhalpur area.

with regard to mining concession For the first three or four years no royalty was to be paid, later on a small royalty beginning with half an anna per ton was to rise gradually to 8 annas per ton Over a term of fifty years the average royalty worked out at 3¼ annas per ton

Messrs Perin and Weld at first chose Sini a junction on the Bengal-Nagpur railway about 60 miles north west of Gorumahisani Hill as the site for the proposed works But on account of the difficulties of water supply and the non availability of large tract of land of suitable type for sinking the foundations this site was given up in favour of Sakchi (now Tatanagar) near the Kalimati (now Jamshedpur) railway station at a distance of 152 miles from Calcutta The first stake was driven at Sakchi on February 27 1908 The non-financial aspects of the investigations of the scheme were of a very difficult and trying nature The financial aspects were rather easier in comparison to the non financial aspects The total financial requirements including block and working capital expenses of promotion etc were estimated at about £ 2 millions

Checking up of investigations—As will be explained later, Tatas tried to approach the financier of England for financial help and on behalf of a group of the London financiers interested in the scheme, Mr J Stoddart, chairman of the Parkgate Iron and Steel Company Ltd, visited India He brought with him Mr William Selkirk, an eminent mining engineer of London Both these experts reported very favourably

(3) ***Assembly*** Properly investigated opportunity of making Iron and Steel in India, along with property-mining concessions in Mayurbhanj State and land for the site of the works, and managerial ability (to be provided by the Tatas) were assembled together to form a "proposition" which was presented to the London financiers

(4) ***Financing*** With an idea of getting most of the finance in London, Messrs Dorabji and Padshah went to England As mentioned earlier a group of London financiers got the scheme examined by their own experts and were satisfied with regard to its soundness But there were differences about the degree of control which was to be entrusted to the representatives of English investors A disposition seemed to be manifested to sweep the Tata firm aside Far more disconserting was the lack of interest shown by the London money market.

Mr Dorabji and Mr Padshah, who had spent weary months in the city of London without avail, after their return conceived, in conjunction with Mr Bilimoria, the bold idea of approaching the people of India for the financial requirements of the new company The decision was a risky one and many predicted failure, but it was amply justified by the result

Prospectus dated August 27, 1907 was issued and the instant response of the people was described by Mr Axel Sahlin at a later date in the following words "From early morning till late at night the Tata officers in Bombay were besieged by an eager crowd of

native investors Old and young, rich and poor, men and women, they came offering their mites, and at the end of three weeks, the entire capital required for the construction requirements, £ 1,630,000 was secured, every penny contributed by some of 8,000 native Indians And, when later an issue of debentures was decided upon to provide working capital the entire issue £ 400 000 was subscribed for by *one Indian magnate the Maharaja Scindia of Gwalior*

The total expenses of promotion of the scheme amounted to Rs 5,25 000 (£ 35 000) *From the time the idea was conceived in* 1882, it took nearly 25 years up to the time of the issue of prospectus in 1907

A very thorough investigation and careful financial planning are of very great importance in the process of promotion of new enterprises In normal circumstances the future success of a well-planned enterprise is almost assured while ill planned enterprises are likely to die in their infancy without attaining the stage of adulthood Even in the case of state enterprises the necessity of thorough investigations in the process of promotion is not less in any way In the present state of our development the investigations are usually taken up by experts provided by foreign collaborators. A few examples may be quoted here to give some idea of the labour and effort involved in carrying out detailed investigations

The story of the investigations connected with the promotion of the Heavy Electricals (Bhopal) may be briefly narrated as follows The proposals for the construction of the plant were submitted by a number of foreign manufacturers After detailed consideration of these proposals the Government of India decided to enter into a technical consultancy agreement with Messrs Associated Electrical Industries Ltd of the United Kingdom in November 1955

The first step in investigations was the preparation of a questionnaire to be circulated to state governments for suggesting most suitable sites for the factory Fourteen sites in different states were suggested. A team of experts appointed by technical consultants assisted by the technical adviser of the concern visited the sites in different states Initially, three sites were suggested as suitable by the experts—(1) Barka Khana (Bihar), (2) Bairagarh (near Bhopal), and (3) Antergaon (Hyderabad)

Barka Khana was only 36 miles from Bokaro and was not accepted being too near a steel plant. The site near Bairagarh was also not acceptable on account of the great depth of the black cotton soil there But another location near Bhopal city was chosen. This site was near the main railway line providing easy communication with Bombay and the coal and steel areas in M P, Bihar and Bengal Good water supply could be obtained from the Bhopal lake and electric power could be had from the Chambal Hydro-Electric Works The site is approximately 1,900 feet above sea level with a equable climate The temperature exceeds 100° F only for 35 days and relative humidity exceeds 75% only for 90 days in the year A detailed project report was submitted by the H E I Ltd in Novem-

ber 1956 and, after careful examination was accepted by the Government of India in March 1957 The construction of the factory was taken in hand in June 1957 and the factory went into production in July 1960

Another type of information throws very interesting light on the dimensions of the efforts and labour devoted to the thorough investigations in the process of promotion of the Heavy Engineering Corporation (Ranchi) The plant is being built in technical collaboration with Czechoslovakia The detailed project report submitted by the techno experts of Czechoslovakia to the Government of India for the foundary and forge plant was said to be as heavy as the project itself The report ran into 42 volumes and weighed nearly 11 5 maunds It contained over 1 500 drawings The report was accepted after careful examination and the plant is under construction The amount of labour and effort involved in investigations leading to the preparation of the report can well be imagined than described The Bokaro Project was first examined by the Indian consultants of the Government of India and these investigations were checked up by the technical experts of the United States Steel Corporation on behalf of the U S Agency for International Development It is said that this study runs into seven volumes References to this study have been made earlier in connection with the points raised by the experts regarding the non financial and financial aspects of the project All these examples lead us to the only conclusion that very thorough investigation and analysis is essential for the promotion of new enterprises

It has been stated earlier that the promoter renders services which are of great economic and social importance and it is therefore reasonable that he should be compensated and paid for these services These services can be classified under two heads (a) incurring of expenses, and (b) assumption of risks He incurs expenses in paying for the services of the consultants and experts, for taking out options, for acquiring properties and for such other purposes which really serve as foundation stones for erecting the edifice of a new enterprise He must be reimbursed for these outlays representing his out-of-pocket expenses at cost without any concealed profits All these expenses are of a determinate nature as their records are made in the books of accounts and are usually supported by documentary evidence The value of the second type of service—the assumption of risk—is almost indeterminable The promoter runs a great risk of not being able to persuade any one to join hands with him in promoting the projected business and thereby losing his out-of-pocket outlays in developing the original discovery He must expect a handsome reward for the assumption of these risks But it is very difficult to determine the quantum of this award

From the theoretical point of view the promoter may be reimbursed in cash for the amount of expenses actually incurred—the out of-pocket outlays, but for the risks assumed by him he may be rewarded by the allotment of equity shares not paid for in cash This

form of payment sounds reasonable on grounds of economic justice In case, the promotion turns out, eventually, to be a failure, the equity shares allotted to the promoter for consideration other than cash will command almost no value in the market and that is what he actually deserves under such circumstances On the other hand, if the promotion is successful the degree of success will be reflected in the value of the shares (inclusive of premium) and naturally in the higher quantum of the reward of the promoter In the case of exceptionally successful promotions these rewards are sometimes quite large and the promoter who gets such handsome rewards, as well as the management responsible for giving such rewards are both subjected to harsh and sometimes uncharitable criticism. But the critics, in such cases completely ignore the other side of the picture The earlier investigations sometimes cost the promoter lakhs of rupees if the project does not reach the stage of becoming a 'proposition', there is no source to which the promoter can look for reimbursement of the out-of pocket outlays, and in such a case the loss is entirely his and his alone The exceptional rewards should really be judged against the background of the possibilities of heavy losses likely to be sustained.

Sometimes the promoter may be compensated by giving him an option to purchase shares of the new corporation at a fixed price within a fixed period of time This is said to be a common practice in the United States of America for compensating the promoter This method offers an opportunity of making substantial gains in the future without immediate investment of money, in case the company is successful and the price of shares rises above the fixed purchase price This option will be exercised only when the shares begin to sell at a premium above the fixed purchase price This method of compensation is again an outcome of the uncertainty that surrounds the chances of success or failure of a new business For giving such option to the promoter, warrants, giving a right to purchase shares in future, are usually issued In a number of notoriously fraudulent cases, the promoters were paid for their services in the form of shares In most of the states of the U S A, laws (popularly known as 'Blue Sky' laws) to protect the interests of the investors from being diluted, have been passed. In extreme cases of fraud, it is said, promoter sold to the investors nothing more than a few feet of the blue sky The 'Blue Sky' laws generally require the shares issued for consideration other than cash to be placed in escrow with the Securities Commission for a certain period Say for example, according to the law of a particular state the promoter s shares will remain in escrow till a dividend of 6 per cent is declared and paid on all outstanding shares. If the company fails before the declaration and payment of 6 per cent dividend the promoter's shares stand at the bottom for payment, they can be paid only when all other securities have been paid off

In theory, according to the foregoing discussion, the promoter may be paid in cash for his out-of pocket expenses and in equity shares for the risks taken and intangible services rendered by him.

But in practice, the modes of compensating the promoter vary considerably from company to company and usually take one or more of the following forms in India

(1) *Commission*—Commission may be paid to the promoter on the purchase price of the property or business acquired by the company through him

(2) *Profit*—The promoter may purchase a business or other property and may be allowed to sell the same to the company at a higher price or he may sell his own business to the company at a profit

(3) *Lump sum*—The promoter may be remunerated for his services by the company by means of a fixed amount of money as a lump sum

(4) *Job or office*—The company may give a good job or some office of profit to the promoter In India, the promoter is usually remunerated by being appointed as the Managing Agent, Manager, Managing Director, Secretary or Treasurer of the company

The remuneration may be paid in cash shares or debentures or partly in one form and partly in another

No one can deny that the promoter spends time and money and stakes his reputation on untried and therefore risky projects and consequently he is entitled to be reimbursed for his outlays and to be rewarded for the risks assumed But the functions performed by him are of a unique and indeterminate nature and his relationship with the company promoted by him of a very peculiar nature, rather difficult to define and delimit He does many things and performs duties on behalf of an entity which has not yet come into existence He, therefore, cannot be defined as an agent as the principal is non-existent He cannot, even, be called a trustee in the full sense of the term because he is interested in profits resulting from successful promotion and is thus not a disinterested person Under these circumstances his relationship with the company and the subscribers is said to be fiduciary—a position of full trust and confidence As a corollary of this relationship the promoter is expected to follow or adopt a definite code of conduct in his dealing with the company He must reveal all facts with regard to the property and other deals which are likely to influence the decision of the company He must not make secret profits out of the transactions he enters into on behalf of the company , he must give to the company the benefit of all contracts made by him on its behalf , he must not make an unfair use of his position and he must disclose all material facts to the company

The promoter must act in full good faith otherwise he may be held personally liable for acts done on behalf of the company during the course of promotion Prior to incorporation the promoter enters into agreements or contracts for materials, real estate or services These agreements and contracts have to be ratified, adopted or assumed by the new company after its incorporation to release the promoter from his personal liability Unless he discloses all the

material facts, relevant to the contract, its adoption or assumption will not be binding on the company, any secrecy or concealment of facts on his part will make his position indefensible in a court of law

The adoption of a preliminary, preincorporation contract between a vendor and the promoter by the company after its incorporation is not sufficient to release the promoter completely from his personal liability The fact that the adoption of a preliminary contract is made one of the objects of the company in its memorandum or articles or that the company has passed a resolution to adopt it will not create a contract between the company and the other party The only way suggested to overcome this difficulty is that the company should enter into a new contract with the vendor drawn up entirely on the same lines and in the same terms as the previous contract entered into with the vendor by the promoter on behalf of the company This procedure is called 'Novation For this purpose a clause is inserted in the articles of the new company which refers to the preliminary contract and provides that the company shall adopt it and that the directors shall carry it into effect forthwith After the registration of the company the adoption is affected by making a *new contract* This contract made between the vendor, the agent and the company, puts an end to the old contract between the vendor and the agent or trustee and incorporates its terms as a new contract between the vendor and the company This relieves the promoter of his personal liability

As a consequence of these difficulties the usual practice now is not to make any contract before the registration of the company but to agree to the form of a 'draft contract' to be entered into by the vendor or the promoter and the company after incorporation This 'draft agreement' is referred to in the Memorandum in the 'objects clause (usually as the first clause) and also in the Articles. This draft agreement is initialled by one or more of the named directors, or by a lawyer, solicitor or accountant of the company The agreement then comes up before the board of directors after the company has been registered and has become entitled to commence business In the meeting of the board of directors, the agreement is adopted, signed and sealed after due consideration.

Promotion and Companies Act

The Indian Companies Act, 1956, is very strict towards those who promote a company and having promoted conduct and manage its affairs. It prescribes a rigid code of conduct for those who promote a company and manage its affairs subsequently The Act requires particular care to be taken while inviting subscriptions for shares or debentures of a company and raising capital The greatest care must be taken in handling funds raised on behalf of the company and must be properly accounted for Thus the Act completely safeguards the investor against fraudulent practices of promoters, directors and others concerned.

(1) *Promoters' responsibility*—Under the spirit of the Indian

Companies Act, the position of the promoter in relation to the company he promotes is assumed to be fiduciary one, i e, a position of full trust and confidence towards the company By virtue of his position as such he must be faithful to the company throughout as he is answerable to the company for all his acts of omission and commission from the time he sets out to form the company He must conduct him very carefully and must not make an unfair use of his position and derive any secret benefits or make any secret profits out of the transactions he carries on behalf of the company When time comes, he must disclose all material facts and render full and faithful account of all profits or benefits to the company He is personally liable on contracts he makes with the vendor or others on behalf of the company during the course of promotion

(2) *Issue of application form for shares or debentures* The Act prohibits issue of an application form inviting subscription for shares or debentures of a company unless the form is accompanied by a copy of the prospectus which contains the terms and conditions of the issue This enables the prospective investor to see for himself the conditions of the issue and the status of the company before applying for shares or debentures

(3) *The issue of prospectus*—One of the important steps in the process of formation of a company is the raising of capital Capital is collected over a wide area in and outside the country The terms and conditions of the issue of capital are set out in the prospectus and the adequacy of finance and the ease with which it can be obtained very much depend on the attractive nature of the prospectus The prospectus, at the same time discloses full facts to the prospective investor The present Indian Companies Act, in order to safeguard the interests of the investor against fraudulent issues, has considerably enlarged the provisions of the prospectus The Act defines the term prospectus to mean any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any shares or debentures' The prospectus must contain detailed information about the company, its financial plan, its management, etc so as to enable the investor to judge for himself whether to risk his money or not The statements contained in the prospectus must be accurate, complete in all respects and true They should not be misleading The prospectus should reveal the facts in their true colour No ambiguous phraseology, unfair reservations or half truth should be allowed to creep in the prospectus The financial statements and opinion of experts, if included in the prospectus, must be supported by the reports of auditors and accountants and the consent of experts If any misstatements are included in the prospectus those responsible for its issue are held liable and the investor can get back his money or damages, as the case may be

(4) *The minimum subscription*—Many a time, companies are formed with inadequate capital These companies either come to grief soon after their formation or have a very bad career In order to check the formation of such under-capitalized companies, the Act prescribes for the minimum subscription The object of this provision

is to prevent any company commencing business unless adequate resources are available to give it a good start. The minimum subscription is the amount which must be raised to provide for the following:

(a) purchase price of any property purchased or to be purchased out of the proceeds of the issue

(b) any preliminary expenses and commission payable by the company to any person in consideration of his agreeing to subscribe for shares of the company

(c) the repayment of any loans in respect of any of the foregoing matters

(d) working capital and

(e) any other expenditure

(5) *Minimum payment with application*—The shares may be so issued as to fulfil the condition of minimum subscription, but the actual payment on each share may be inadequate. The Act, therefore, provides that the amount payable on application on each share shall not be less than 5 per cent of the nominal amount of the share. The company is also under an obligation to see that every shareholder pays the said amount and that no allotment is made without compliance with this requirement. Any allotment made without payment of at least 5 per cent of the nominal value of the shares is, therefore, invalid.

(6) *Return of application money in case of failure of the subscription*—There may be cases of fraudulent formations of companies without any intention of commencing a business. The motive may be simply raising money from the public fraudulently. The Companies Act, therefore, enjoins on the promoters to keep the application money received from applicants for shares deposited in a scheduled Bank in a separate account till the company gets the minimum subscription and the certificate for the commencement of business. If the conditions of the minimum subscription or of 5 per cent application money are not fulfilled and as such the company fails to get the certificate for the commencement of business, the application money must be returned with interest to the applicants concerned.

(7) *Issue of shares at a discount*—Ordinarily, every shareholder is required to pay the full nominal value of his shares in cash and a company is forbidden to issue shares at a discount. Even if the company is in difficulties or wants to compromise a creditor's claim, it cannot issue shares at a discount. A contract for doing so is void. This provision is a check against granting favour to certain shareholders and disfavouring others.

(8) *Issue of shares at a premium*—A company has power to issue shares at a premium. There was no specific provision in the Indian Companies Act for the proper application of premium so received prior to 1956 with the result that misuse of funds thus collected was not lacking. The Act has, therefore, now laid down specifically how the premium collected on the issue of shares should

be utilized The Act prohibits distribution of share premium by way of dividend The amount of premium is termed as a separate class of paid up capital of the company and is kept intact till the winding up of the company The Act, however, permits the application of the share premium to write off capital losses of the company

(9) *Underwriting of shares*—Underwriting is a method by which a company which offers shares for public subscription ensures that the whole of the issue or at least a part of it to cover the amount of minimum subscription is taken up It is done by means of an underwriting contract entered into between the company and a financier The promoters may themselves serve as underwriters and charge high rate of commission or they may contract with a weak financier to underwrite the shares of the company resulting in a failure ultimately, thus involving in trouble all the subscribers of shares of the company In order to safeguard against malpractices and misuse of power, the Act requires the disclosure in the prospectus of the names of underwriters and the opinion of the directors that their resources are sufficient to discharge the obligation The Act also requires disclosure in the prospectus of the amount of commission paid to a promoter or officer of the company during the preceding two years of the issue of prospectus The Statutory Report should mention the reasons for the failure of an underwriting contract

(10) *Capital of managing company*—There have been cases where the capital of the managing agency company has been inadequate as compared with that of the managed company The Company Law Committee suggested that the intending subscriber was entitled to information about the financial standing of the managing agency company and the Company Law requires the disclosure of this information in the prospectus

(11) *Property to be purchased and vendors thereof*—It is just possible that financial frauds might be committed by promoters in the transactions relating to purchase of property for the company The Act, therefore, requires disclosure in the prospectus of full facts about the property to be purchased and the vendors thereof The information must be given for the transactions of purchase of property that might have taken place in the preceding two years

(12) *Other disclosures*—The Act also requires disclosure in the prospectus of other matters likely to help the investor in arriving at a correct judgement about the company and its finances and management etc , viz

(a) Preliminary expenses and the persons by whom these expenses have been paid

(b) Any benefit given to a promoter or officer in the two preceding years and the consideration for the same

(c) Particulars of all material contracts made in the two preceding years

(d) Full particulars about the interest of any director or promoter in the company

5

Factors Affecting Long-term Finance

Middle of 18th century represents a line of demarcation between the old and new methods of production. As a result of the changes brought about by Industrial Revolution old methods of production were replaced by new methods. In the old method the tools and appliances which assisted the artisans in the process of manufacture were simple and cheap, but the new methods required not only complicated and costly appliances called plant and machinery but also costly buildings called factories and workshops in place of domestic places of work. The modern factory buildings, plant and machinery are far more costly and durable in comparison to the appliances of the old system. Most of the modern means of production are of a durable nature, and render useful service for long periods of time. Naturally, funds and finances required for acquiring fixed assets of a long term nature have to be employed over long periods of time. The need for collecting large amounts of money for long periods of time has led to the emergence and development of certain principles which are helpful in the management of funds employed in business and industry for long periods of time. The principles form the basis of financial policies formulated by managements but in practice the policies are modified under the influence of environmental factors. The principles of long-term finance and the factors affecting the actual patterns of long term finance are to be discussed briefly in the following pages.

The assets to be acquired by different types of businesses are very varied in character, some of them last as long as the business lasts itself, others last for a long but definite period, still others serve only for short periods. Logically, the funds required for the first category of assets should be obtained from a source prepared to wait for the repayment almost indefinitely, the funds for the second category should be obtained for a definite period repayable at a fixed future date, the funds employed for the third type should be returnable at the end of the short period for which they were obtained or at short notice. In actual practice, it is found difficult to realize these ideals and the management has to deviate from the ideal under the influence of factors which are either internal or external.

Internal factors

Age of the business or industrial unit Just like the individual human beings the individual firms or companies also pass through different stages of their life-cycle, after their birth or incorporation they pass through the period of childhood and then attain maturity and adulthood and finally reach the old age and infirmity, in the end they also die like human beings through the process of liquidation, and cease to exist The requirements of life of the human beings are different at different stages of their life In early childhood or infancy milk is the main support of life, but in youth, representing the period of vigorous growth, all types of nourishing food both liquid as well as solid is consumed But when old age sets in, the requirements of food decrease and one has to become selective in the matter of consuming different types of food available to safeguard his digestion from being impaired Almost similar principles hold good in the case of individual firms and companies During the period of early childhood the temper of activities rises slowly and income is insufficient to meet the obligations In such a situation it is desirable that equity shares or common stock provide *the necessary base for procuring funds and long-term fixed* charge securities are not issued

The amount of funds required initially may, however, influence the choice and judgement of the management Certain types of businesses like the iron and steel making or automobile manufacture require huge sums of money initially for setting up a unit of a reasonably efficient size The huge amount of funds required make the approach to the capital market and to the various classes of investors almost inevitable and the management finds it difficult sometimes to confine its choice to equity shares or common stock only It takes recourse to a wider range of securities to obtain the necessary funds But sometimes the risks involved are so great that even in the case of a large business the management tries to confine its choice to equity shares or common stock only

A properly nursed enterprise attains adulthood and enters upon a period of balanced growth As the intake of food of a grown up human individual is more and varied and the power of achievement great, so the financial requirements of a successful adult business unit are far more in comparison to its early days and its increased productive capacity usually brings in higher incomes Rising income provides the necessary bases for the addition of fresh capital Increasing capital needs have to be, and can safely be, met by tapping varied sources of capital supply During the period of vigorous growth and rising incomes fixed charge securities can be issued safely and advantageously Success of the business helps to establish confidence in the minds of even the conservative suppliers of capital and this period is most suitable for embarking upon capital operations usually known as 'trading on equity' Cheap capital from outside is used advantageously for paying higher dividends to equity shareholders This is also the time for preparing well-drawn

up plans of debt reduction and for putting them into operation to conserve a part of the rising incomes to meet the debt obligations in future at their maturity

Slow growth is financed many times from internal resources—saved earnings—of a prosperous business But sometimes the opportunities of rapid growth and expansion unfold themselves suddenly in several new directions and progressive and energetic managements try to take such opportunities by the forelocks For meeting the requirements of rapid growth and expansion they have to issue a variety of securities—shares bonds and debentures—to make the broadest possible appeal to different type of investors During such periods a judicious use of fixed-charge bearing securities along with bonus shares and rights issues is perfectly justified both in theory and practice In India at the present time we are actually in the midst of such a period of planned rapid growth of industries

In the case of human individuals after maturity the old age begins to set in the strength and working power declines, the digestion gets impaired and one has to resist the temptation of rich foods A wise man winds up his affairs and finally dies peacefully. Similar is the case with firms and companies. The period of development and maturity of individual units may be long or sometimes very long but in the long run each and every unit has to face decline and ultimately death Many times the ultimate death is postponed for long through the process of reconstruction, modernization and refinancing. But ultimately like human beings, institutions are also mortals. In a business unit the setting in of decline and old age may be heralded by a decline in incomes and earnings A wise management should meet the situation created by the decline in the income by bringing about an equal reduction in the fixed charges. This should be done by the retirement and discharge of debt and other fixed-charge bearing securities by using the funds accumulated through the process of sinking funds and other similar reserves created during the period of prosperity and growth. As the earnings decline a parallel reduction both in assets and obligations is desirable Finally, as the management feels that its services are no longer required by the community, the remaining assets should be sold off and the proceeds utilized for paying off all contributors of capital—owners as well as creditors—an alert and honest management working under normal circumstances should be able to pay off all bonds and debentures at their different dates of maturity, to redeem the preference shares and to return to the equity shareholders an amount equal to their original contribution plus an amount of the residuary surplus remaining at the end after meeting all other obligations In principal an ordinary shareholder who remained a member of the company from the day of promotion to the day of final dissolution or liquidation should have received in dividends and the return of the principal a total sum equal to the amount of his original capital contribution plus a normal rate of return on his investment

Control of management. At the time of promotion of a new

company usually there is a small group of influential persons who take initiative in organizing the company They also have in mind the idea of retaining permanent control over the management of the company This may be done by keeping a major part of the voting power in their own hands They might also desire to secure control by minimum investment in the form of capital Long-term financial policies of the company are affected considerably by this desire of a group to keep the management permanently under their control Majority of the equity shares may be taken up by the group or a substantial portion of the voting shares may be allotted to shareholders scattered over a wide area These shareholders may not find it possible to be able to present themselves in the meetings to influence the voting The desire to retain control with a minimum amount of investment may result in the issue of a substantial amount of non-voting securities like preference shares or of creditor securities like debentures and bonds This device enables the influential group to acquire control over a large proportion of company s assets with minimum investment The same result can be obtained by issuing equity shares of a lower face value say Rs 10/- and non-voting preference shares of a higher value, say Rs 100/ Formerly deferred shares of Re 1/- were also used almost for the same purpose

Reputation of management and credit-worthiness of the concern. Management acquires reputation by showing good financial results When persons who have shown good results in other ventures are connected with a new concern, their names inspire confidence in the investing classes Similarly, when a concern has been earning good profits for some time, investors are willing to provide fresh funds for its expansion as the unit is considered credit worthy These factors help the company in securing necessary finances on better terms , required amount of capital may be obtained by issuing preference shares having no special privileges like the participation features or conversion rights , and even unsecured debentures may be issued without any difficulty To the contrary, a company which does not enjoy the privilege of having some persons of good managerial reputation on its board of management or does not have a good record of credit-worthiness may find it very difficult to issue securities which do not carry an attractive (usually higher) rate of returns or to which some special privileges have not been attached

Rate of returns and the stability of earnings

(a) *Rate of Returns*—If a business enjoys a high rate of returns it is likely to finance its growth and development by ploughing back its own earnings Such a business is not likely to sell securities to any substantial extent to obtain further capital required for expansion Higher rate of return is a clear indication of the existence of a potential for expansion and retained profits are usually employed to finance the growth of such a business But in a business where the returns are moderate retained earnings cannot be

expected to play an important role and expansion may have to be financed by an issue of new securities which might include debentures and preference shares besides equity shares. A company with poor returns is not likely to have any substantial amount of retained earnings but on the other hand it may have so little investment appeal that there may be no alternative except to rely on its own poor resources for financing its growth.

(b) *Stability of earnings*—A number of factors may influence the stability of earnings; two of them—volume of business or sales and profit margin—are more important. The volume of business may fluctuate on account of the competition from other units, shifts in fashions or styles, or on account of the influence of business cycle or the changes in the use of substitutes. The changes in the margin of profit may take place on account of cuts in prices by competitors, slow turnover of the stock or the difficulties imposed by inflexible costs of production.

The volume of business seems to be more stable in certain types of industries than in others. The volume of business of consumers' goods industries is usually more stable than those of the producers' goods industries; the sales of the products of food industries are more steady than those of the iron and steel or construction industries; industries producing articles having low unit prices like cigarettes or matches enjoy more stable volume of business; company enjoying monopolistic or semi-monopolistic position on account of control of raw materials, secret processes or patents or franchise may also enjoy the benefits of the stability of the volume of business.

In devising the capital structure the stability or unstability of earnings should be given due weight. More conservative opinion is that industrial enterprises (as distinguished from utilities) should not include fixed charge securities at all in their capital structure, but a little less conservative opinion is that the use of fixed charge securities in the capital structure of the industrial companies should be so limited that at least twice the amount of fixed charges payable is earned during the least successful periods of working of these concerns. Industries which earn handsome profits sometimes and only meagre profits at other times are designated 'prince and pauper' industries. Companies in such fields usually require costly fixed assets and they can use a substantial amount of borrowed capital for acquiring the fixed assets only if they conserve a good proportion of their earnings when they are princes to meet the fixed charge obligations during the lean periods when they are paupers. The same principle is to be applied in the case of companies whose earnings are irregular. The averages of irregular earnings over a period of time might justify the issue of fixed charge securities if the dips in earnings are carefully set off against the peaks by properly conserving the peak earnings to meet the obligations during the periods of dips. On the whole the general principle to be followed by concerns subject to the risk of unstable or fluctuating earning is

that as far as possible the issuance of debt securities should be avoided, of preference shares should be kept at a minimum and of equity and bonus shares should be favoured and relied upon In the case of public utility concerns the earnings are more or less regular and steady and in their case debt and fixed charge securities can form a large proportion of their capital structure In the U S A, the capital structure of certain gas and electric companies consisted of equity securities only to the extent of 30 per cent and rest of the 70 per cent comprised fixed charge securities (debt 50 per cent and preference 20 per cent)

Nature of assets Tangible assets with long life of usefulness are sometimes considered to provide a good basis for the issue of long term securities Similarly current assets are associated with short-term finance It is thought that the soundness of assets for borrowing purposes is closely related to the physical and productive length of life of individual assets although this life may sometimes be shortened on account of new inventions or technological developments, and the assets may be rendered obsolete long before the redemption of the securities issued against them Assets of a very highly specialized character unsuitable for other alternative uses and the wasting assets like mines which get exhausted during the course of normal operations and are non reproducible, are less suitable as a basis for the issue of long term securities As a result of long experience modern trends seem to indicate that long physical life of assets does not insure either stable capital value or a steady flow of earnings to provide a sound basis for the issue of fixed charge long term securities, while permanent need for current assets like the stocks of materials or saleable goods may be considered as a desirable basis for long term financing This tendency is discernible in the shifts in the financial practices followed by American railways and tobacco companies The railways try to avoid long term debt and to use their own retained earnings for financing equipment they resort to intermediate credit The tobacco companies, on the other hand, are replacing a part of their bank loan finance by long term debt

Ratio of fixed and working capital The ratio that fixed capital bears to working capital is also said to be a factor which affects long-term financial policies This ratio to a very great extent is the result of the nature of the industry in which a particular unit is operating It is also dependent upon the inclusion of several stages of working within one unit, purchasing, fabricating, setting and customer financing functions may or may not all be performed by the same unit A firm simply engaged in distribution needs most of its funds in the form of working capital, while another firm undertaking manufacturing business requires major part of its funds in the form of fixed capital It seems logical that a firm using major part of funds as working capital may not obtain its capital on the long term basis while another firm which requires major part of funds as fixed capital may take recourse to the use of the instruments of long-term finance and credit But as pointed out previously long term assets represented by fixed capital do not

greater For units in such industries it is advisable that they should include more of equity securities in their capital structure as compared to the units in those industries where the competition is not so intense

Condition of the investment market—The choice and preferences of the investors for different type of securities continue to change from time to time Custom and experience give rise to likes or dislikes of the investors at a particular time for certain types of securities Usually during the periods of brisk industrial activity equity securities may be favoured by investors and during the periods of dullness in the industrial field investors may be favourably inclined towards bonds or debentures High rates of taxation may also sometimes discourage investment in equity securities At certain periods of time certain types of securities are more popular than others with the investing classes of people In India investment in Government securities was more popular than the investment in industrial securities Custom and experience may be partly responsible for such attitudes exhibited by the investors and partly they may be the results of mere whim and prejudice But these investor preferences and attitudes exercise a considerable influence on the choice of the managements of industrial concerns in selecting the types of securities to be placed in the investment market at a particular time with a view to reducing the cost of financing or to ensure the supply of necessary funds On account of the conditions prevailing in the investment market at a particular time a company may be forced to issue a particular type of security it does not prefer and may have to undergo the ordeal of refinancing at a later date

Rates of interest prevailing in the market—Theoretically when the conditions in the capital market are normal and the interest rates are considered to be normal the rates for comparatively short term funds are lower because from the point of view of the suppliers of funds short term contract implies less risk and greater liquidity to the contrary the rates for funds required for comparatively longer periods of time must be higher because more distant future implies diminished liquidity and greater risk But when the conditions in the capital market are not normal and the prevailing rates of interest are either low or high the trend of thinking and reasoning on the part of supplier of funds will be different If the prevailing rates of interest are considered to be low the supplier of funds will be very hesitant in committing their funds on the basis of long term contracts as they expect the rates of interest to rise in the near future They would naturally like to supply funds for short periods on the basis of short term credit instruments But when the interest rates are considered to be high the suppliers of funds feel more interested in long term securities because they wish to seize the opportunity of entering into a long term contract on favourable rates before they begin to decline

The rate which an individual company must pay for obtaining the necessary funds is determined besides the general level of

interest rates prevailing in the market at the time of financing, by the credit standing of the company in the market and the form and type of security chosen to be offered The choice of the form or type of security, in its turn, is dependent upon the comparative costs of alternative forms, the degree of risk to the company involved in the use of various forms and the availability of finance During the last few decades the cost of debt finance has been lower in comparison to preference or equity finance Under such conditions debt financing may be chosen in spite of the risk it involves on account of its cheapness and availability Then again as between the short-term and long term debt the weaker companies may resort to short-term debt because it is cheaper and more readily available although it involves a potential threat to solvency on account of the recurring necessity of repayment and renewal In some of the industrially advanced countries the short-term bank lending rates are lower than bond yields During such periods of low short term rates there is a strong temptation to obtain funds on the basis of short maturities of low cost But it may be more prudent for average company managements to secure long-term finance on somewhat higher rates to safeguard themselves against still higher rates and paucity of funds later on The higher cost at this time may be justified as it assures a command over funds obtained now over a longer period For companies, having a strong financial position, it may be economical to pay a higher bank rate and wait for a future opportunity of financing on a lower yield debenture basis rather than to commit themselves over a longer period at a higher current rate on long-term debt securities A safe and conservative opinion, however, is that where there is a possibility of making choice, it is better to decide in favour of long-term financing so as to be able to secure the benefit of the device of liquidating the obligation gradually and conveniently from funds set up for this purpose rather than be compelled to take resort to refinancing operations under uncertain and probable inconvenient conditions prevailing in the capital market in future

The preference shares carry with them a minimum obligation on behalf of the management to pay regularly the stipulated rate of return or to repay the principal Preference capital assumes more risk in comparison to the debt capital and as such normally costs more than the debt capital Large sized companies with a better credit standing are in a better position to sell preference shares in comparison to the companies of a smaller size During the period of the upswing of the business cycle, when business confidence is high, preference shares can be sold easily almost on debenture or bond yield basis The conditions are likely to be equally unfavourable during the period of difficult or unhealthy business conditions

In the case of the cost of equity capital a rough measure of cost is the relation of earnings to the price per share A correct measure, however, would be the relationship of future earnings to the price because a particular price is paid in the hope of expected future earnings But the future earnings may be over- or under-estimated and accordingly the relationship of current earnings to

price may be out of line at a particular time. In America during the later period of the second World War the investing public supplied the equity capital at a price which gave a return of 7 per cent only because the people thought that the earnings were depressed only temporarily on account of excess profits taxes. Similarly during early post war years the common stock was selling at a price on which nearly 14 per cent was being earned currently because the investors thought that the earnings were temporarily inflated on account of inflationary pressures and the post war boom was not going to last long.

The choice of proper time and opportunity is much more important in the case of new issues of equity shares than in the case of debt securities or redeemable preference shares because a debenture or redeemable preference issue with a high yield can be refinanced at a lower rate at a suitable future opportunity but the same procedure is not applicable to equity issues. A wise management should avoid scrupulously the issue of new equity securities at a time when the price received for the new shares is likely to be lower than the value behind the existing equity shares or the proportion of future earnings to be given to the holders of the new issue is likely to be much higher than the new funds can earn. When new equity financing reduces the earnings per share or the asset value per share a state of dilution is said to have occurred. This type of financing causes a deep injury to the interests of the old shareholders which cannot easily be repaired. On account of these implications the proposals for new equity financing need all possible caution and the most serious thought and consideration on behalf of the management.

Income tax policy of the state—Two aspects of the income tax policy of the state require consideration. Firstly, the interest on bonds and debentures is deductible for income tax purpose while the dividends are not, and secondly, the rates of corporation taxation have been rising continuously for some time and have reached a very high pitch at the present time. Roughly speaking the debenture yield and dividend rates in India during the last few years have been about 4, 6 and 10 per cent respectively, while the income tax and the corporation tax taken together on large companies and after making allowance for rebate has been about 50 per cent of the taxable profits. This means that a company can pay 4 per cent interest on the borrowed capital by earning 4 per cent only but for paying a preference and ordinary dividend of 6 and 10 per cent it must earn double the amount, i e, 12 and 20 per cent respectively. If a company employing a substantial amount of borrowed capital can earn 20 per cent on its capital it can save 16 per cent after paying 4 per cent debenture interest and after paying 50 per cent tax it can still have 8 per cent to provide for a sinking fund to meet its debt obligations in about twelve years. This situation puts a premium on debt financing as compared to financing with ownership securities. But the risks involved inherent in debt financing have to be taken into consideration.

6

Capital Structure

After discussing some of the important factors to be taken into consideration by the managements of companies in shaping their long term financial policies we now proceed to examine the bases of determining the amount of long-term capital required and the forms of securities to be used for raising the total amount of capital In this connection it is necessary first of all to mention some of the important terms used by different writers on the subject Some writers use the term capitalization to represent the total sum of all the long term obligations of the company in the form of ownership and borrowed capital and they refer to the various kinds of securities that make up the total amount of ownership and borrowed capital as the capital structure Some other terms like financial plan and financial structure are also used almost in the same sense in which the terms 'capital plan and 'capital structure' are used Authoritative writers, however, try to make some distinction between the different terms for the sake of clarity and clear understanding These writers use the term 'capital plan' to denote all long-term capital including share capital, funded debt, surplus, surplus reserves and undivided profits, while the term 'capital structure' is used to denote only the total of outstanding long-term securities, both *ownership and debt The term financial plan relates to the* discussion of all liabilities, short-term and funded as well as share capital, surplus, and net worth reserves The financial structure is said to be the broadest of all these terms and it relates to the discussion of all the items on both sides of the balance sheet, meaning thereby a discussion of all the items on the liabilities side including entire capital and other items denoting indebtedness of the company and the relationship of these items to the assets of all types on the other side of the balance sheet The phrases which frequently occur in the books of company finance are 'capitalization' and 'capital structure' but the increasing use of shares with no-par value or with only a nominal par-value in America has created difficulties in the use of these terms with a precise meaning and consequently some of the writers have stretched the term 'capitalization' to include capitalization and surplus and have adopted the term 'invested

capital as synonymous with capital structure The practices adopted in the field of company finance in India are not so complicated as yet and we may use the term 'capitalization' to mean the amount of ownership and borrowed capital to represent the long term indebtedness of the company, and the term 'capital structure' to denote the kind of securities that make up the capitalization. Besides representing the amount of long-term obligations of a company the term 'capitalization' is also used when retained profits are made a permanent part of the long term capital by issuing bonus shares to the existing shareholders This process is called *the capitalization of* retained earnings or profits Similarly when total earnings along with *the current rate of interest are used for calculating the total* capital the process is called the capitalization of earnings

We may now proceed to discuss capitalization and its bases first and then to take up the problems relating to capital structure subsequently When a new unit is to be established or an existing unit is to be expanded the amount of capital required for the purpose *has to be estimated* *The earnings and cost theories of* capitalization are employed for estimating the figure of total amount of capital required for starting a new unit or for expanding an existing one

The earnings theory of capitalization

Houses are built on sound foundations and no one can build on sand Similarly, industrial *structures have to be* supported by the sound foundations of earnings If the earnings are inadequate the industrial structure will collapse *So in the earnings theory* the net income or earnings are taken as a basis to work out the figure of the total *amount of capitalization which can be supported* by the estimated earnings First of all the current market rate of return per hundred is taken and hundred divided by *this rate gives* the number of times that the total capitalization would be of the estimated earnings For example, *if the current market rate of return* is 10 per cent and the estimated earnings are Rs 5,000 per annum, then the total capitalization would be *worked out in the following manner* The amount of the principal 100 divided by the rate 10 gives 10 as the multiplier. Now Rs 5,000, *the amount of earning multiplied* by 10, gives Rs 50 000 as the amount of capitalization If the rate of return is 8 *then the multiplier will be* 12½ and Rs 5,000, the amount of earnings, multiplied by 12½ will give Rs 62,500 as the amount of capitalization.

In this process of calculating the amount of *capitalization two* major factors of very great importance are involved, one of them is the estimation of the probable amount of the *future earnings of* the enterprise, which is to be started and the other is the rate of return Both of them require careful consideration

The earnings are usually estimated by forecasting the volume of sales and sales expenses on the basis of an appraisal of the business and economic conditions prevailing in the country in general and in industries which are likely to absorb the products of the new

concern as well in the industry in which the new unit is going to be started in particular The other factors taken into consideration in estimating earnings are the scale of operations of the proposed unit and the costs of production on the basis of the costs of raw materials labour and various other elements required in the process of production The estimated earnings may also be compared with other units of a similar size, age location and experience operating in the particular branch of industry in which the new unit is going to be started

The rate of returns to be used for the calculation of capitalization has to be estimated and worked out carefully First of all a careful study has to be made of the rate of return which similarly circumstanced units in the same industry are actually earning on their capital and then the mood of the capital market has to be taken into consideration indicating the rate at which the market is capitalizing earnings in the case of the enterprises of this type In cases where there are divergences between the rates of returns actually being earned by similar type of units in the same industry and the rate at which the market is capitalizing the earnings for similar concerns, the rate of return estimated for capitalizing the earnings in the proposed unit, has, of necessity, to reflect the mood of the market, i e a rate higher or lower than the one supported by other factors may have to be adopted to meet the requirements of the investment market

The cost theory of capitalization

At the time of estimating the capital requirements of a new or expanding company the cost of the physical assets of a long-term nature, and other costs of starting and establishing the unit are also taken into consideration along with the expected future earnings of the enterprise The process of estimating the total requirement of funds on the basis of the cost of assets to be acquired and other related costs is known as the cost theory of capitalization Under this theory the estimates of the capitalization of a company are based on the cost of fixed assets like buildings, plant and machinery, patents etc , the amount of regular working capital, preliminary expenses, the cost of obtaining the capital, cost of establishing the business (represented by expected deficits in early years of the life of the company, and other costs) These estimates arrived at on the basis of current prices of fixed assets give a good idea of the capitalization needs of a new business But they play only a secondary and subordinate role in determining the capitalization of competitive industrial enterprises subject to variations and fluctuations in their earnings The cost of fixed assets ceases to play an important role in the affairs of competitive enterprises just after they have been acquired and paid off Subsequently they might be idle, they might become obsolete or their products may not be in good demand Under these conditions their power of earning may not remain the same as it was in the beginning or as it was

expected to be at the time of their purchase. This situation will make the price paid for them initially, even after making customary allowance for depreciation, an extremely poor basis for judging the usefulness and value of the enterprise. For these reasons the application of the cost theory of capitalization is not appropriate for competitive enterprises with irregular earnings. In the case of such enterprises the earnings theory of capitalization is more useful and therefore plays the dominant role.

The cost theory has, however, its own usefulness and its own fields of application in public utility undertakings. Companies operating in these fields enjoy a certain amount of monopoly privilege against which the public has to be protected by rate making authorities. In the case of these companies capitalization bears a relationship to the value of assets. The price of service allowed to be charged by the public utility undertakings is calculated on the basis of a fair return allowed on the investment. This allowed rate of return is based upon assets and not upon securities. In the process of regulation, the value of assets is determined first and then a rate of return considered to be fair under the existing economic environment is adopted. Finally the price schedules for the services to be provided by the public utility undertaking are adjusted in such a manner so as to provide earnings that will give the allowed rate upon the evaluated capital. There has been a considerable degree of disagreement on the question whether the value upon which investors deserve a return should be the historical cost of the properties at prices originally paid, after adjustment of depreciation according to age or the reproduction cost of similar equipment at prices prevailing at the time of evaluation. In general, the historical cost is considered to be a better basis in comparison to reproduction cost. The rate base is to consist of solid physical assets and intangibles are not to be included. Amounts of cash spent for acquiring the right-of-way and other privileges, cash spent for meeting organizational expenses and the deficits incurred during the developmental period may be temporarily included in the rate base but must be subsequently written off gradually leaving only physical assets to form a permanent rate base.

With the help of the earnings and the rate of return estimated by using the method discussed above and the cost of assets the total amount of the capitalization can be determined which has to be secured by judicious and careful selection of different types of securities to be sold by the management of the proposed unit. To use a slightly less technical language the security-wise arrangement of the total amount of capital is called capital structure. For all practical purposes capitalization and capital structure appear to mean the same thing and whatever distinction there may be is only technical.

Factors affecting the stability of earnings

Before taking up the discussion of the capital structure a few more observations appear to be necessary about certain factors which affect the stability of earnings in competitive industrial enterprises.

In fact real financial foundation for supporting the capital structure of all types of units—industrials or utilities—is provided by earnings and, therefore, their stability is of great significance The earnings may fluctuate but their average over a period should provide an adequate return on capital employed during the entire life of the company Not only interest on debt and dividends on share capital must be paid but the amount of the principal and the share capital paid into the company originally must also be returned intact If this can be accomplished the returns can be said to be adequate otherwise they would be inadequate If the earnings over a number of years are shown on a graph, a curve of earnings would be obtained For regulated public utility enterprises the curve of earnings is said to be 'allowed , because, as mentioned earlier, the prices charged for their services by the public utilities and the rates of return on their capital are fixed by some regulating authority set up by the state and the earnings provided by the selling price must be sufficient to support the capital structure Under normal conditions the curve is *expected to be smooth But in the case of industrial concerns the* earnings are conditioned by the competitive market forces of demand and supply and the curve of earnings of these types of concerns is, *consequently, said to be 'derived' This curve is usually of a wavy* nature The earnings of these undertakings may fluctuate between the lowest and the highest points at two extreme points but on the *average they must be sufficient to support the capital structure in the* long run

There are several factors which influence the trend of earnings in the case of industrial companies and they have to be given due weight and careful consideration by the managements in their calculations and estimates of earnings at the time of designing the capital structure of a new concern or of an expanding unit The scale of operations—small or large, degree of mechanizations—low or high, and the nature of production—continuous production, fabrication of producers goods or the manufacturers' goods, influence considerably the quantum of earnings from year to year by causing variations in the costs within the unit itself in relation to demand for its output The ability of small and large units to adjust their costs and output in relation to variations in demand differs widely from industry to industry In some industries the small and less mechanized units find it easier to adapt themselves to variations in demand and the fluctuations in their earnings may be of a mild type , in some other industries the large and more highly mechanized units, though less adaptable to changes in demand, may be in a better position to absorb the shock of an adverse business cycle through their conserved earnings Large scale and mechanized units employing a continuous process of production like oil wells, blast furnaces and tanneries experience great difficulties in adjusting their volume of *production and costs under adverse demand* and business conditions and their earnings are likely to experience wider fluctuations In producer goods industries, the relative reduction in demand for *their goods is likely to be much steeper in* comparison to the

reduction in the demand for the products of the consumer goods industries To take an extreme example, a 50 per cent reduction in demand for cloth might bring about a 100 per cent reduction in the demand for looms for weaving the cloth It is quite clear, consequently, that the fluctuations in the earnings of the producer goods industries are likely to be much more violent than they can be expected to be in the earnings of the consumer goods industries

Besides the factors mentioned above exerting their influence on the supply side there are others which operate on the demand side of the industrial companies The industries have to compete among themselves for obtaining their own supplies of materials, equipment and machinery and labour the prices they have to pay for these things also affect their earnings Vertical combinations are sometimes formed to overcome the ill effects of the fluctuations in the open-market prices of the basic materials used by the manufacturing units at different levels Organization of the units at different levels, as in the case of iron and steel and mineral oil industries, into an integrated unit helps to overcome some of the unsettling effects of price variations in the supply of materials In the case of expansion or combination the stability of earnings cannot always be assured because the increased output may be obtained at increasing unit costs or may have to be sold at lower prices

In addition to these economic factors some unpredictable factors may also lead to variations and fluctuations in earnings Government control is an important factor of this nature Regulation and control of industries by the Government is playing an important role in India as well as in other countries and has to be reckoned with in estimating earnings Production, sales, consumption, price of materials, components or the final product may be controlled or regulated not only in commodities like liquor, narcotics or tobacco but also in other types of commodities like sugar or cement All these controls affect the trend of earnings of the industries Tariffs and export and import controls may benefit one set of industries but they may also affect another group of industries rather adversely These measures taken by the Government may also influence the earnings of the industries considerably The foregoing discussion suggests that the various factors affecting the trend of earnings of the industries should be taken into careful consideration in estimating the earnings and the capitalization of competitive industries The quantum of earnings, and their comparative stability or unstability in case of particular industries are the questions which have to be answered satisfactorily by careful analysis before taking a decision with regard to capitalization

Capital structure

After arriving at or determining the total amount of capitalization the next step is concerned with the choice of securities to be issued for obtaining this amount The securities thus chosen for raising the total amount make up the capital structure of the com-

pany. A good and sound capital structure should possess some basic qualities. First of all the capital structure should be simple so that the intending investors in different types of securities can easily visualize their respective position with regard to their rights. Simplicity can be secured by issuing only a small number of well defined types of securities conferring clearly defined rights on their holders. This quality of capital structure is not of much significant importance in countries like India where the types of securities to be issued are already small and well defined. But it is meaningful in countries like the United States of America where the classification and sub-classification of securities is rather large and where Common Stock, Preferred Stock and Bonds can be of several sub-classes. In India there can be only one type of ordinary shares and there is no room for the issue of classified common stock. Simplicity of capital structure implies the issue of only one class of ordinary shares and only one class of debentures or bonds so that the question of the existence of several classes of ordinary shareholders and debenture-holders with varying and complex rights does not arise. This type of structure is very advantageous from the point of view of management and administration of capital.

The capital structure should also be *conservative*. This quality greatly enhances the financial reputation of the company and consequently the possibility of successful subsequent financing in future. Conservative capital structure implies the inclusion of those types of securities in the capital structure of different types of undertakings which are considered to be most suitable to their peculiar circumstances, say for example, the capital structure of a manufacturing company would be considered conservative if major part of it consists of equity shares and preference shares have been excluded from its composition; but inspite of the presence of a certain proportion of creditorship securities along with the equity shares the capital structure of a public utility company would be considered to be conservative on account of the peculiar nature of this type of enterprise. The composition of conservative capital structure will differ from industry to industry according to its nature.

A very important quality of the capital structure is its *flexibility*. The factors which influence the policy of long-term finance affect the capital structure favourably or unfavourably at a particular period of time. Flexibility helps the management in obtaining the favourable and in avoiding the unfavourable effects. In the case of ownership capital the redeemable preference shares provide the necessary element of flexibility. If there are chances and opportunities of refinancing at cheaper rates at a subsequent period of time they can be used advantageously by redeeming the preference shares carrying a higher rate with funds obtained at a cheaper rate. This reduces the fixed charges and relieves the strain on the finances of the company. In the case of creditorship securities like debentures or bonds flexibility can be secured by reserving the company's right to pre-pay i.e., the right to pay before maturity or due date, judicious staggering of the

maturities of the debt securities, reservation of the freedom of further financing and avoidance of acceleration clause in the provisions relating to the serial redemption of debt securities are some of the other methods which can be used with advantage for providing the necessary element of flexibility to the structure of debt securities which form part of the capital structure of a company A proper balance between equity and debt securities is also essential as too much of debt securities might make the capital structure top heavy likely to topple down under adverse circumstances

Proper selection of securities from the point of view of marketability is also essential for devising a good capital structure In the early stages of financing the best securities (usually having special privileges attached to them) should not be offered, rather they should be reserved for the last It may be better to start with equity securities and add debt securities later on when such a step seems to be justifiable on the basis of the soundness and stability of earnings An additional quality of good capital structure should be that it should be built up by incurring the *least possible costs* in obtaining the desired funds in the form of brokerage, underwriting expenses, etc

An analysis of the capital structures of public utility enterprises and industrial companies would generally reveal that the proportion of long-term debt in relation to equity capital is much higher in the former type of concerns than in the later type of units, mainly because the earnings of the industrial companies are unstable and the investment in long-term assets is proportionately small, industrial concerns naturally use more of equity capital and try to avoid the burden of fixed interest charges Within the industrial and commercial group itself variations in the composition of capital structure are reasonably expected to exist In the basic sub-group the iron and steel industry generally employs a substantial amount of borrowed capital besides the equity capital because its long term assets like land, buildings, plant and machinery provide a reasonably good basis for borrowing, but in the extractive industries like coal mining, the wasting assets are hardly acceptable to investors as security for long term debt without stringent sinking funds provisions correlated to the amount of coal raised. These circumstances restrict the choice of the management mostly to the equity securities for raising the long term capital In the manufacturing and fabricating sub group industries like machine making and automobile manufacture the major part of investment may be in current assets like raw materials or in wages, in tobacco manufacture or tanning major part of investment may be in raw materials like the tobacco leaf, hides and skins, and in industries manufacturing agricultural implements major part of capital invested may be accounted for by the stocks of finished goods or bank accounts Most of these forms of assets are suitable only for short-term bank borrowing and do not provide a good basis for long term debt In all such types of industries ownership capital, mainly equity, should play the predomi-

nant role In commercial and financial companies undertaking wholesale trade, financial broker's business or commercial banking, very small amount of long-term capital is required and it should *mainly take the form of equity capital* The table given below gives a general picture of the capital structure of some of the important types of Indian industries

Percentages of the total capital

Group	*Industry*	*Ordinary Shares*	*Preference Shares*	*Deferred Shares*	*Mortgages and Debentures*	*Total*
Public Utility	*Electricity*	*65 1*	*10 6*	—	*24 3*	*100 0*
Basic Industries	Iron and steel	39 7	48 4	4 5	7 4	100 0
	Coal mining	72 7	12 1	—	15 2	100 0
Fabricating and Manufacturing Industries	Engineering	72 0	16 0	—	12 0	100 0
	Cotton	80 5	15 5	1 0	3 0	100 0
	Jute	68 7	24 0	—	7 3	100 0
	Sugar	75 0	12 0	1 0	12 0	100 0
	Cement	89 6	3 9	—	6 5	100 0

Source Taxation Enquiry Commission

The actual situation conforms broadly to the theoretical considerations The highest proportion of debt capital is found in the electric companies and in other industries the proportion of equity capital is usually high

Some broad principles of a very general nature have been laid down by authoritative writers to be taken into consideration by the management at the time of devising the capital structure (a) When a new company is to be started in an unproven field of industrial activity or when fresh capital is required by an existing company whose previous earnings have been unstable, it is considered prudent *to obtain the necessary capital on the basis of equity shares* (b) Non-voting preference shares may be issued to obtain a part of the capital if it is desired to keep the managements in the hands of a restricted class of investors usually belonging to the groups of promoters But when preference shares are issued it should be seen *that the annual preference* dividends are covered by at least half a decade's past or prospective earnings (c) When a company has become well established and the earnings have become stable, cheap borrowed funds may be used to the advantage of the equity shareholders during the periods of prosperity This process is called 'trading on equity' But when bonds or debentures are issued to obtain these funds, care should be taken to see that at least one and

a half times the interest charges had been earned by the company during the worst year of the last five accounting periods. (d) When funds are obtained on the basis of a mortgage issue, the total amount thus obtained should not exceed half the depreciated value of the assets covered by the mortgage. (e) Some cautious and conservative people hold the opinion that the total long-term funded debt should not exceed the net working capital, which is defined as the excess of current assets over current liabilities. These principles can ordinarily be applied under normal circumstances; they may not be applicable in all conditions and in all circumstances and the actual form of capital structure of a particular company promoted at a particular time under particular conditions and circumstances will always finally depend upon the experience and judgement of the people responsible for the management of the company.

7

Over- and Under-Capitalization

Our discussion so far has been confined to the methods of estimating the amount of capitalization and the choice of securities for setting up the capital structure to obtain the estimated amount of funds These discussions were related to the items which represent the capital of the company on the left hand side of the balance sheet (the liabilities side), i e , the details of capitalization in terms of securities—ordinary and preference shares, debentures and bonds But as soon as the management begins to use the funds collected through the sale of securities for acquiring fixed assets the attention is also diverted to the right hand side of the balance sheet usually called the assets side This brings us to the point where we begin to take a comparative view of the liabilities and assets which are shown respectively on the left and right hand sides of the balance sheet So long as *the amounts received by the sale of securities remain in the* form of cash both sides are equal The liabilities show the total *obligation of the company to the security-holders and assets consisting* of cash only show the possessions of the company matching *exactly its obligations on the other side But this fine balance gets* disturbed as soon as the cash is replaced by physical assets like Land and Buildings, Plant and Machinery, Equipment and Appliances etc The assets thus acquired take the shape of an establishment—mill, factory, workshop etc , and their organized form gives them a value known as the 'going-concern value' which they did not possess previously If the earnings of the new establishment are satisfactory the going-concern value of the unit may be higher than the total sum of the prices paid for the individual assets separately The business may be built up slowly and patiently and its earnings might rise to a point higher than the one attained by other similar enterprises operating in the same field of industry The management will earn *the reputation of investing the funds of the security-holders* prudently

The reverse is also possible The assets are purchased and are organized in the form of a going concern but the earnings of the new unit fail to justify the expectations of the people responsible for *promotion and management* On account of lower earnings the

(1) ***Capitalization of earnings*** This method has already been discussed earlier as one of the bases of the estimation of capitalization Briefly stated the method is that the annual future income of a company is estimated for a series of years, and then the average annual income is capitalized at a suitable rate The whole thing is not so simple as it seems to be The first difficulty is that the estimates of the future have to be based on the experience of the past But the present and past earnings cannot necessarily provide a sound basis for forecasting the future earning power, if a short period is taken for averaging purely temporary conditions may influence the results unduly and if too long a period is taken the past influences which affected the earnings may no longer be valid or relevant Second difficulty is presented by the rate at which the earnings have to be capitalized The rate of return is really the rate of interest plus profit for the amount of risk involved in a particular enterprise In practice the rate means the percentage relationship between the price buyers are prepared to pay for a particular security at a particular time and the dividend they expect to get on the basis of the security to be purchased Prospects of a particular industry appear to be bright sometimes and sometimes they appear to be dismal Accordingly, the price the investors are prepared to pay for the security of this industry appear to be too high or too low in relation to the dividends or yields and the percentage relationship between the prices and the yields becomes variable and the capital value of an enterprise worked out on the basis of such rates may not be in line with the actual value of the enterprise In brief both the elements—annual earnings and the rate of return—entering into the mathematical calculations of value based on the capitalization of earnings are variable and therefore may not give accurate results. In spite of these difficulties the promoters, investors and the operators on the security markets evolve their standards which serve their needs for all practical purposes

(2) ***Market value of outstanding securities.*** Under this method the market price of each class of securities issued by the company is taken The price is adjusted to remove the effects of capital or seasonal variations and then by multiplying it with the number of outstanding securities the total value is found out to which the short-term liabilities are added to arrive at the total value of the company It is claimed that the current market price of the securities represents an up-to date estimate of the value of the concern and has the backing of the representative opinion of the investors The main weakness of this method is that the securities for which the market prices are quoted usually represent only a small fraction of the total holdings as the securities in the hands of long-term institutional investors and the block holdings of the management group do not form part of the market supply Sometimes the securities of a very sound unit may be sold by the owners on account of their own financial difficulties Widely held securities of public companies may also be purchased and sold by the people not well informed about the position of the company or the industry mostly acting on the advice of professional

operators who very often take into consideration the forces likely to influence the market in the near future and not the underlying factors The method has another very serious limitation, it can be applied only to those companies whose securities are listed on the security exchange markets

(3) ***Historical cost*** This is said to be an honest and straightforward method as it is based on the record in books of the original investment made at the time of purchase less depreciation The total depreciated value of all the fixed assets summed up mathematically along with the value of current assets can give the value of the company as a whole But there are numerous stages in putting the simple theory into practice In a fairly large sized business different assets might have been acquired and disposed of at different times and might have been improperly recorded or some of the records might have been lost or destroyed the amount of depreciation might not have been properly estimated or regularly written off If the historical cost method is strictly applied costs incurred on building up the business in earlier stages its earning power, and reputation may be left out of account as they may not be represented by any tangible assets There is one more point The theory of historical cost seems to be based on the assumption that in a competitive economy the investments in acquiring the assets have been made prudently so that the assets possess competitive productive and earning power in relation to other similar assets In such cases the cost of the assets of the company will be equal to the capitalized earnings But those who are familiar with the history of promotions know that it is full of instances of imprudent, rackless, dishonest and fraudulent investments The directors have been known to have purchased properties from the parties in whom they were interested at highly inflated prices Even in cases where investments are made honestly a prudent investment made earlier might become valueless after a lapse of time

(4) ***Cost of reproduction.*** Under this method the cost of obtaining or reproducing the assets at present prices is estimated ; to these estimates indirect costs as well as the costs of land, buildings, equipment, stock etc are added, and from the total depreciation is deducted to arrive at the present value This method may be used either for estimating the cost of reproducing an *identical* plant under existing conditions or for estimating the cost of a plant capable of rendering an *equivalent* service On account of the technological development during the period between the establishment of the original plant and the estimate of the cost of reproduction the costs for the identical plant and equivalent plant may not be the same This method is considered superior to the historical cost method as it takes into account the changes in the price level as well as in the field of technology The use of this method is more appropriate in estimating the cost of putting a competitive plant The reproduction cost of an identical plant may also be favoured by the utility concerns when this is likely to give them an advantageous rate base—the values obtained by the use of this method are likely to be higher than

the historical cost during the period of boom and rising prices, and lower during the period of falling prices

(5) *Liquidation or scrap value*—If the owners come to the conclusion that it is no longer profitable to carry on the business operations, they might decide to sell the assets When this situation arises the business loses its going concern value and the assets can be sold for a price which represents the sum of the value of each asset to the purchaser The value of a dead business which has failed is really the scrap value of its physical assets After discussing the different methods of valuation it has to be said at the end that the income of the company as a whole constitutes its underlying life immeasurably more effective than all of its physical assets The value of a particular asset or set of assets is governed by the series of incomes derived from the sale of products made with the help of the asset or the assets and the character and value of the products may change through inventures or changes in fashions during the life-time of the asset or assets and the only practicable method of ascertaining the money value of such asset or assets may be to capitalize the net income which the asset or assets may yield

Under- or over-capitalization

Our discussion of the various methods of valuation brings us to the conclusion that as soon as the cash received by the sale of securities is spent by the management in acquiring the assets, an element of uncertainty is introduced and it is difficult to find out the exact and correct value of the assets on account of the changes in techniques, price level, etc In the light of these discussions we have now to examine the concepts of under or over-capitalization In non-technical language these terms show the relationship of the value obtained by the company by issuing different type of securities with the value of the assets it has purchased or obtained for carrying on its operations For the sake of brevity we intend to use the term 'capitalization' to denote the total value of the outstanding securities In cases where the total par-value of the securities of a company is equal to the stated value of its total assets the company may be said to be properly capitalized Such a situation exists when the securities of a company have been issued for cash fully paid and the total amount received has been deposited in the bank Total value of the securities would appear on the liabilities side and the total cash would appear on the assets side of the balance sheet Both would be equal and the capitalization would be said to be proper But when the total par value of the securities is less than or greater than the stated value of the total assets the company would be said to be under- or over-capitalized The presence of surplus on the balance sheet would show that the company is under-capitalized and similarly the presence of deficit would show that it is over-capitalized When property and assets have been acquired by spending cash and the company begins to function, the total value of securities outstanding may be equal to the stated value of the total assets From the point

of view of the accountant the company is properly capitalized but from the theoretical point of view of an economist it may not be so. There may be uncertainties about a rise or fall in the value of land or there may be uncertainties about the expected performance of the plant; expenditure on intangibles like promotion and organization might have been included in the cost of the assets. On account of these factors an economist may not be prepared to accept the point of view of the accountant that the total value of the outstanding securities is equal to the stated value of the total assets. From this strict theoretical point of view the state of proper capitalization may never exist after the investment of the amount of share capital in physical assets: it may be either under-capitalization or over-capitalization.

A theoretically ideal situation can be visualized under the conditions of perfect competition when capitalization would always be proper as one or both of the two situations would prevail: (i) the total amount of securities issued at par would neither be more nor less than required to obtain the amount of capital that a company producing at minimum unit costs for a given demand would use; (ii) the outstanding securities would command a market value equal to their face or par value; fixed-charge securities like preference issues or debentures would bear a competitive rate; and the equity-holders would receive a competitive market rate of return for risk capital in the industry to which the company belongs. On occasions when excess profits or net losses are expected or anticipated, a well informed market under perfect competition would discount these expectations or anticipations and force the present values into line for all old and new producers. Under such conditions of perfect competition the discrepancies between capitalization and the value of total assets could not last long. But we live in a world of imperfect competition and the discrepancies between capitalization and the value of total assets do exist in the realm of reality; these discrepancies may appear either as a state of under-capitalization or over-capitalization.

Under-capitalization

The concept of under-capitalization is applied to two opposite financial states of companies: (a) the company may be highly successful and prosperous and it may be enjoying a surplus, and (b) the company may have too little capital to conduct its business and it may be facing serious financial difficulties. The discussion of the position of a successful and prosperous company will be taken up first.

(*a*) Some writers hold the opinion that this type of under-capitalization is more common than over-capitalization. A surplus balance sheet is generally considered to be the hallmark of good management and respectability and probably most of the companies try to achieve this objective. Conservative managements try to acquire it, the speculative minded try to parade it, and if it does not exist the elemental

pride seems to be hurt and efforts are made to conceal its absence There is no doubt that the maintenance of surplus reserves or unappropriated surplus in reasonable amounts to meet the problems created by the changes in capital values is one of the important duties of a wise and conscientious management, but to accumulate more than what is likely to be needed to meet reasonable contingencies is against the best interests of the company and the investors

Symptoms of under-capitalization are (a) the rate of profits on total capital may be exceptionally high in comparison to the rate of return enjoyed by similarly situated companies working in the same field of industry , and (b) the shares of the company may be selling at a high price

Probable *causes* responsible for the emergence of the situation are (a) at the time of promotion the earnings might have been under-estimated or the rate chosen for capitalization might have been too high , (b) the assets may be worth considerably more than the values appearing in the books , (c) property acquired and paid for in shares might have been under-valued , (d) too liberal depreciation might have been allowed , and (e) a rise in the general price level might have taken place

Effects of under-capitalization may be as follows (a) *Unfavourable*—(i) The prices of equity shares of an under-capitalized company will rise An investor of ordinary means would not like to buy high-priced securities and consequently they are likely to be less widely distributed (ii) The presence of surplus on the balance sheet raises the book value of equity shares but the buyers in the market refuse to offer prices equal to the net-worth per share on account of the element of uncertainty about the future use of the surplus (iii) High profits, real or imaginary, encourage the promoters and investors to start new companies in this branch of industry and the intensity of competition is increased thereby (iv) Under-capitalization invites the criticism of the consumers that high profits have been wrung from them by monopolistic practices (v) The workers might put forward their claims for higher wages by saying that large surplus has been accumulated by paying them low wages (vi) Adverse public opinion might lead the Government to take an unfavourable view and to set up a commission to enquire into the alleged monopolistic practices, concentration of economic power and financial control over production and distribution of goods and services The charges might prove to be incorrect but the reputation of the company may be damaged for a long time to come if not permanently

Effects (b) *Favourable*—(i) The presence of surplus is considered to be a sign of conservative management and increases the prestige and creditworthiness of the company It affects the opinion of the short-term creditors favourably and it increases the margin of safety for the debentureholders (ii) The smaller number of shares makes it easier for the management to maintain the rate of dividend

Remedies—(i) The shares of higher value may be split up to

make them of lower denomination Say for examples the shares of the face value of Rs 100 each may be split up into four shares of Rs 25 each This device only helps to change the external appearance of excessive prosperity by reducing the amount of dividend per share It does not modify or remove the underlying cause responsible for the emergence of the situation (ii) The real remedy is to issue bonus shares or to pay stock dividend This will increase capitalization and bring it in line with the value of total assets The rate of returns on shares will decrease as the earnings will be spread over a larger number of shares The rate of return will come in line with the rate of returns prevailing in other similar units in the industry

Certain other remedies like the payment of a bond dividend in place of a stock dividend or the sale of certain assets like investments and the payment of cost dividends to the shareholders appear to be of a less practicable nature

Since the beginning of planned industrial development in India the tempo of industrialization has increased tremendously The general price level has also been rising since the end of the second World War This situation has favoured the prevalence of the state of under capitalization accompanied by prosperity The quantum of retained profits and the frequent issue of bonus shares very clearly support this point of view The Taxation Enquiry Commission (1953 54) reported that during the period 1946 51 nearly 40% of the net profit was retained in the industry Another study undertaken by the Reserve Bank of India for the period 1951 55 also showed that the retained profits during the period amounted to about 39% of the total net profits With regard to the capitalization of the retained profits an analysis of the capital issues during 1952 57 shows that 18 7 per cent of the sanctioned total amount of capital issued was accounted for by the bonus shares

The second type of situation of under-capitalization arises mainly on account of improper or wrong estimation of the financial needs of the business resulting in a meagre supply of capital funds. This situation has no relation to methods or bases of valuation of the assets owned by the company The company has to face serious financial difficulties because initially it was started with insufficient or too little capital Such a situation existed in India up to the time of the second World War The situation was described by Messrs. Samant and Mulky in their book, *Organisation and Finance of Industries in India* published in 1937, in the following words

"When we turn to examine the financial condition of our companies we find that miscalculation about capital requirements is a common malady from which they suffer The phenomenal company failures which took place after the war boom was over were due mainly to this defect. But one need not think that the concerns floated under the feverish boom activity only suffered from financial miscalculation. This defect existed long before many a witness for example, before the Indian Industrial Commission had complained of

it As a matter of fact, the complaint about insufficient capital supply has been there ever since the beginning of modern industrial system in India The worst of it is that the same situation has continued to this day without any improvement in it, and the evidence before the recent Banking Enquiry Committees bears ample testimony to this "

The share capital must be sufficient to provide for (a) the organizing expenses incurred in the beginning, (b) the assets necessary to make the project complete and to bring it to working condition, and (c) the necessary working capital But our companies far from making any provision for the last mentioned item, find the funds insufficient even to make the project a complete entity The history of almost every enterprise worth the name will prove this To choose a few randum instances we may refer to the following cases (1) The C P Portland Cement Co was started in 1919 with an authorized capital of Rs 1 crore with Messrs Burn & Co of Calcutta as Managing Agents Out of 1 crore, 60 lakhs were issued for public subscription As it was the boom period and the company was promoted by a reputed agency firm the capital issued was easily subscribed, not only this but the shares were soon at a premium of 40 to 80 per cent The capital raised in this way was exhausted in no time and the directors were required to raise more funds by issuing the remaining shares of 40 lakhs But by this time the boom was over and owing to the financial difficulties the credit of the company reached a low ebb As a result of both these events the late issue could not be disposed of at all In the meanwhile the agency of this concern was taken over by Messrs Mathura Das Gokul Das of Bombay who raised a debenture loan of 40 lakhs This was also exhausted and then the agents raised another 20 lakhs by a second debenture loan The company wanted to erect three units of machinery and up to this period they were working for all the three units, but after spending 120 lakhs the three units were only half finished And the agents made an appeal for a further sum of 15 lakhs in order to finish *only two units Five lakhs were necessary for completing the two units* and ten lakhs as working capital The company afterwards passed into the hands of the debentureholders who were the members of the agency firm (2) Financial straits resulting from insufficient share capital had to be faced by the Tata Power Co also The company was registered in 1919 with an authorized capital of 9 crores out of which only 4 5 crores were issued Afterwards it was found that the funds raised were not sufficient even to complete the construction The company later on took a debenture loan of 2 crores from the Tata Hydro Electric Company and brought the construction to working condition (3) Similarly the Andhra Valley Power Supply Co also had to undergo the unfortunate experience of shortage of capital A time had reached when this company would have been obliged to close down but for the friendly assistance of one of the Bombay banks on the personal guarantee of the Managing Agents The last two concerns were floated by a firm of no less repute than the Tata Sons Ltd These three instances will show how defects arise in capitaliza-

tion even with regard to the companies floated by the most reputed industrialists Obviously the conditions must be worse with regard to the companies floated by less able businessmen

The difficulties arising from insufficient share capital are in no way peculiar to Bombay Industrial establishments in other provinces like Madras and Bengal are labouring under the same difficulties In Bengal all sorts of industrial establishments whether jute, coal, tea, rice, or oil mills are suffering form insufficient share capital [1]

The description is self-explanatory and requires no further comments As discussed earlier the situation has changed almost entirely

Over-capitalization

Sometimes sanguine promoters take for themselves or give to their underwriters too much shares in return for the services rendered by them which are of an intangible nature, sometimes people who start new enterprises build ahead of their markets, and sometimes the organizers of combinations over-estimate the economies of large-scale organization and production In such cases either the expected high earnings do not materialize or are not enough to meet the requirements of the payment of dividends at the rates currently prevailing in the industry to which the new company belongs In many of the great mergers which took place in the U S A in the past, preference shares or bonds were issued equal to the full amount of the tangible assets and ordinary shares were given liberally to all those who had to do something with the organization of the combination These practices gave rise to the use of the term watered stock or watered capital

Symptoms of over-capitalization are (a) Amount of securities outstanding exceeds the current value of assets (b) Earnings are not large enough to yield a fair return on the amount of the securities (c) The shares are selling at a low price

Probable causes responsible for the emergence of the situation may be—(a) At the time of capitalization either the earnings were over-estimated or the correctly estimated earnings were capitalized at a too low rate (b) Watering of stock or capital took place at the time of original issue on account of the over-valuation of tangible or intangible assets and the issue of fully paid shares to vendors or promoters for such tangibles or intangibles (c) Improper depreciation policy has been followed (d) The general price level has been declining

Effects of over-capitalization may be (a) *Unfavourable*—(i) It is just possible that the promoters have taken for themselves a substantial amount of equity shares and with the help of the voting power thus acquired, have elected themselves as directors and then as directors they have declared good dividends in place of conserving

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1 D R Samant and M A Mulky, *Organization and Finance of Industries in India* 1937, p 99

the earnings for strengthening the tangible assets in order to eliminate over-capitalization Or the presence of a substantial proportion of fixed-charge securities leaves little out of the total earnings for paying reasonable dividends and for investment in tangible assets for reducing over capitalization Such a situation might tempt the management to neglect the proper maintenance of assets or the necessary provision of depreciation (b) Efforts to pay reasonable dividend, at the cost of maintenance and depreciation, at an inflated capital structure might invite competition (c) The existence of proportionately more securities than the invested capital might give rise to the suspicions of monopoly practices and the charging of high monopoly prices This may injure the reputation of the company The financial position of the company may deteriorate so much that it may finally result in failure and dissolution

Effects (b) *Favourable*—The favourable effects do not seem to be many It may be said that the presence of a higher proportion of ordinary shares offers greater protection to the creditors But this advantage remains only imaginary unless the element of water in the stock or share capital is squeezed out This is possible only by injecting conserved earnings, if available, into the assets to strengthen them so that the intangibles like 'goodwill' are replaced by tangible and solid assets When this is achieved the protection afforded to the creditors by the equity which appeared to be artificially thick becomes a solid reality

Remedies—(a) The best remedy is to squeeze the water out of the share capital by ploughing back the conserved earnings Two examples may be taken from the history of the combination in the United States of America to illustrate this point The United States Steel Corporation was formed in 1901 by the consolidation of a number of companies The shares of the new corporation were given in exchange for the shares of the merging corporations on a very liberal basis The total capitalization amounted to \$ 1,400 million as against the total valuation of either the original investment or the physical properties on a very liberal basis amounting to not more than \$ 800 million Thus the new corporation stood over-capitalized to the extent of \$ 600 million Conserved earnings were used for reducing over-capitalization and by 1910, the value of tangible assets stood at \$ 1,187 million as against the total capitalization of \$ 1,400 By 1914 there were almost no intangible assets in the balance sheet which showed an undivided surplus of \$ 150 million F W Woolworth Company was formed in 1911 by the amalgamation of a number of small companies It was over-capitalized at the time of incorporation but by 1930 the earnings of the company were increased from \$ 5 million to \$ 25 million and in 1930 the balance sheet of the company showed a sizeable surplus , the goodwill was shown at a nominal value of \$ 1 only In both cases over-capitalization was turned into under-capitalization (b) Over-capitalization can also be corrected by reducing the amount of the par value of outstanding equity shares

It is also said that the only insurance against over-capitaliza-

tion is under-capitalization and the premium of that insurance must be paid by those who supply the equity capital by foregoing the receipt of a part of the funds available for dividends

Over-capitalization in modern company finance is not a frequent occurrence Some of the writers hold the opinion that a company should not be branded as over-capitalized simply because it is not able to produce adequate earnings currently if its balance sheet does not contain intangibles and the tangibles are shown at cash cost minus depreciation The term over-capitalization is a sort of stigma and implies a certain sense of wrong doing It should, therefore, be applied to situations where there has been an obvious failure to pay in full par value for the shares issued In countries like the United States of America emphasis on par value in the discussion of under- and over-capitalization is declining on account of the increasing use of no par shares The emphasis is shifting to the assets side of the balance sheet The Securities and Exchange Commission, under its regulations requires the companies to disclose not only the methods of accounting but also of valuations, some of the courts also have held in their decisions that goodwill based on anticipated earnings as opposed to those from past earnings, is not property and therefore not a valid consideration for an exuberant issue of shares These attitudes are proving very helpful in curbing the unhealthy practices responsible for the emergence of the state of over-capitalization

8

Long-term Finance in India

(Traditional Agencies)

Capital is the predominant factor of production It is the life-blood of modern industry The more modern an enterprise, the more is the capital needed therein, so much so that the capital invested in the railway industry is as much as five to ten times of the annual output. In manufacturing industries, although the proportion of capital and output is not so high, yet the more complicated the process of manufacture, the higher is the proportion of capital as compared to the annual output The following figures be studied

Total capital compared to annual output of certain industries

(Rupees in crores)

Industry	*Annual output*	*Total capital invested*	*Total capital shown as percentage to annual output*
Railways	349	1033	300
Chemicals	48	61	127
Glass	5	6	120
Paper	18	20	111
Cement	23	24	104
Bicycles	4	4	100
Iron and Steel	72	63	87
Cotton textiles	295	238	81
Sugar	77	55	77
Jute	113	67	60
Vegetable oils	85	23	27
Soap	15	7	47

It will be observed from these figures that in industries like chemicals, glass, paper and cement the total capital invested is greater than the value of annual outturn while in the bicycle industry the capital is equal to the annual output Among other industries of

relatively less highly capitalized character, iron and steel, cotton textiles, sugar and jute may be mentioned, the capital in them being more than 60% of the annual production

Types of capital

(a) *Fixed and circulating capital* In general, capital invested in industry takes two forms (a) fixed capital, and (b) circulating or working capital The fixed capital is the core of the business, the main bearing round which the circulating capital revolves The former is spent in obtaining the fixed assets and the essential property while the latter is available for meeting day to-day working expenses The former provides the necessary means of production, while the latter provides all other expenses that are necessary in order to make and sell the product or service offered The one is static, while the other is dynamic Again, the former is of a long-term nature, while the latter is of a short-term character

The fixed assets needed generally are land and buildings, plant and machinery, furniture and fixtures, tools and implements, railway sidings and roads, bridges and culverts, electric and sprinkler installations, vehicles, livestock, tube wells, quarry and laboratory equipment, etc , all of which go to form fixed capital The working capital on the other hand is either invested in stocks of raw materials, stores and finished products, loose tools and spare parts, or is needed for granting credit to customers, or for meeting day-to day administrative and other expenses such as salary, wages, repairs and renewals, etc The circulating capital is perpetually in motion

It must, however, be remembered that circulating capital can be turned into fixed capital and *vice versa* When machinery is bought or extensions and improvements are made to buildings out of profits, the sum involved moves from the circulating capital into the fixed capital When an obsolete machine is sold for scrap or an unwanted building is disposed of, the sum received—provided it is not required for other machinery or buildings—would pass back into circulating capital and be used for the company's trading again An interchange of this nature goes on in the background of most businesses, but the transactions are usually of a very minor nature, and the movement does not affect the fact that every item of the total capital employed in any business at any moment is to be found either in the circulating capital or in the fixed capital There is no third form of capital in the business [1]

The relationship between fixed and working capital may differ from country to country, from industry to industry in the same country, and even from unit to unit in the same industry In more advanced and highly industrialized countries like the United States, a very high degree of mechanization has been attained In such countries not only manufacturing industries but even homes are mechanized In these countries usually there is scarcity of man-power and therefore, naturally the proportion of fixed capital to

1 T G Rose *The Internal Finance of Industrial Undertakings*, 1958 p 9

working capital is much higher In less advanced countries the proportion of fixed capital may not be so high

With regard to industries, the degree of mechanization and automatization as also the size of unit must generally determine the proportion of fixed and working capital The iron and steel, hydro-electric, mining metallurgical, and heavy engineering industries are usually organized on a large scale, and require a greater proportion of fixed capital on account of higher degree of mechanization and *automatization* [1] *On the contrary, in consumer goods industries like* cotton textiles the value of raw materials and labour is so substantial that the proportion of working capital is much greater than that of the fixed capital Similarly in a mail order concern where the *operations consist entirely of simple office accommodation,* furniture and fixtures or warehouse and packing facilities the fixed capital is very small in relation to the circulating capital

Among our own industries, there are on the one hand such highly capitalized industries as glass, chemicals, cement, paper, wherein the fixed capital is two to three times or even more of the working capital, on the other hand, there are industries such as cotton textiles, sugar, soap, etc, wherein the proportion of fixed to working capital is reversed Midway between these two extremes are iron and steel, jute and vegetable oil industries, wherein the two types of capital bear an almost equal proportion The following figures may be usefully quoted in this connection

Percentage of fixed and working capital

	Industry	*Fixed Capital*	*Working Capital*
A	Glass	72	28
	Chemicals	65	35
	Cement	63	37
	Paper	62	38
B	Cotton textiles	35	65
	Sugar	37	63
	Soap	37	63
C	Iron and Steel	46	54
	Vegetable oils	49	51
	Jute	44	56

The chief reason of a higher proportion of fixed capital in such cases is the use of costly machines of huge size requiring spacious premises and costly building accommodation Out of

1 "The nature of an industry has a great deal to do with the relative proportion between block and working capital required The more roundabout and complex the processes of production grow, the greater must be the proportion of fixed to working capital In such industries as hydro electric, iron and steel and even in jute and cotton, block capital is very large in relation to working capital" (Saroj Kumar Basu, *Industrial Finance in India*, 1953, p 5)

Rs 105 04 crores invested in fixed assets of the Tata Iron and Steel Company as on 31st March, 1948, for instance, Rs 103 25 crores (i e, 98%) was invested in land and buildings and plant and machinery Again, out of Rs 42 67 crores invested in fixed assets on the same date about which details are available, Rs 31 99 crores (i e, 75%) was invested in plant and machinery alone and Rs 8·93 crores (i e, 21%) in land and buildings and only a small sum of Rs 1 74 crores (i e, 4%) was invested in all other fixed assets as given below

Furniture and office equipment	Rs 70,34,000
Live-stock and vehicles	Rs 36,00,000
Development property	Rs 23,24 000
Railway sidings	Rs. 23,18 000
Mining rights	Rs 21,24 000
Total	Rs 1,74 00 000

The problem of industrial finance however, is not so much the problem of an industry as a group but of its individual units separately and it may be noted that the proportion of fixed and working capital in individual units does not always bear a close relationship to that of the industry as a whole For instance, in the iron and steel industry the fixed capital is 46% of the total capital and the working capital 54% of the total, while the fixed capital invested in the Tata Iron and Steel Company Ltd., is 71% of the total, thus being two and a half times of the working capital. The fixed capital in the cement industry is 63% of the total, whereas the fixed capital of the Dalmia Cement (Bharat) Ltd is only 23% of the total, i e, being less than a third of the working capital This is so, because in the same industry the process of mechanization may not be similar in different units In mechanized units the proportion of fixed capital is greater, while in units where manual processes predominate the proportion of working capital is greater The following table gives the percentage share of fixed and working capital of certain selected units of various Indian industries

Percentage of fixed and working capital to total capital[1]

(Rupees in lakhs)

Industry	*Fixed Capital*	*% to Total*	*Working Capital*	*% to Total*
1 Cotton Textiles				
Asoka Mills Ltd, Ahmedabad (1949)	1900	17	9,489	83
The Tata Mills Ltd., Bombay (1956)	124	48	134	52
2 Iron and Steel				
Tata Iron & Steel Co Ltd., Bombay (1958)	10,504	71	4,368	29

1 Calculated from Balance Sheets of Companies concerned.

3 Cement				
The Associated Cement Co Ltd Bombay (1957)	1953	47	2,105	53
Dalmia Cement (Bharat) Ltd (1956)	69	23	307	77
Orissa Cement Ltd (1956)	111	44	250	56
The India Cements Ltd (1955)	100	58	72	42
4 Jute				
Anglo Indian Jute Mills Co Ltd (1950)	67	25	207	75
The Standard Jute Co Ltd (1956)	39	37	65	63
Chitavalsah Jute Mills Co Ltd (1951)	21	13	135	87
5 Coal				
Amalgamated Coalfield Ltd (1956)	27	50	27	50
Bengal Bhatdee Coal Co Ltd (1956)	3 6	37	6	63
Bharat Collieries Ltd (1956)	67 7	49	68 7	51
6 Tea				
Amluckie Tea Co Ltd (1955)	6	21	21 9	79
Banarhat Tea Co Ltd (1955)	19	21	73	79
7 Sugar				
Belapur Co Ltd (1956)	39	17	202	83
The Gwalior Sugar Co Ltd (1955)	18	36	32	64

It may be noted that working capital in most cases is more than the fixed capital, varying from two to five times the fixed capital In a few units such as the Tata Iron and Steel Co Ltd and the India Cements Ltd , however, the fixed capital is greater than the working capital being 71% and 58% respectively of the total capital

Thus it is not possible to lay down a hard and fast rule with regard to the proportion of fixed and working capital in any industry or unit , only outstanding tendencies have been indicated

(*b*) ***Long-term and short-term capital.*** Generally speaking all the *fixed capital is long term and all the circulating capital is* short-term But a part of the circulating capital which is necessary for holding a minimum level of raw materials, stores and finished goods in an industry is sometimes regarded as long-term in character and only the balance is treated as short-term capital

(c) ***Medium-term capital.*** Although at any given moment in the life of a concern there exist only two forms of capital fundamentally and statistically, viz , fixed or long-term and circulating or short-term capital But from the standpoint of availability of finance, there is also an intermediary class termed as medium term capital It is that part of the capital which is needed by an industry for the purpose of extension and replacements It is difficult to calculate the proportion of medium-term capital as the published balance sheets or other statistical data do not publish this figure separately The requirements of medium-term finance also vary from industry to industry, from unit to unit and also from time to time in the case of the same industry or the same unit A newly set up industrial unit

may not require any medium-term capital for a number of years till some of the machinery or other equipment becomes unserviceable On the contrary, an old established unit or one contemplating certain rationalization schemes may require substantial amount of medium-term capital

There is no unanimity of opinion regarding the period for which short-term, medium-term and long term capital is required by industries The committee on State Industrial Finance Corporation in West Bengal (1951) defined the three terms in these words short-term credits as those for periods up to one year, medium term credits as those advanced for periods ranging from one year to ten years and long term credits as those made for periods over ten years This definition was also accepted by the Committee on Finance for the Private Sector popularly known as the Shroff Committee which reported in 1954 [1] This classification, however, can only serve as a working guide and should not be regarded as sacrosanct or static In Germany, short-term credits are available for a period of less than one year, medium term credits for periods of one to four years and long-term credits for periods of four years and longer [2] The distinction is based on banking practices in vogue in that country In Austria short-term credits allowed by banks are up to 12 months, medium-term credits from one to five years and long term ones for periods over five years In Great Britain, the most typical of new institutions providing long term finance to industry is the Industrial and Commercial Corporation Ltd , which advances loans redeemable over 5 to 25 years Thus, the practice of European countries seems to regard short-term finance up to one year, medium-term from one to five years and long term for periods above five years and this distinction seems more desirable and nearer practical considerations and may better be adopted by us [3] The Refinance Corporation for Industry, the institution mainly catering for medium-term finance in India, normally used to grant loans from three to seven years and in exceptional cases up to 10 years

Forms of long-term finance

Long term finance usually takes three forms (a) shares, (b) debentures, and (c) loans The primary source of long term finance is the share capital When a joint stock company is formed, it invites the public to subscribe funds in the form of share capital Debentures and loans are only a secondary source of long-term finance and may be relied upon to finance schemes of extensions or improvements or of rationalization

Shares may be (a) equity or ordinary, and (b) preference Prior to the passing of the Companies Act, 1956, there used to be a third

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[1] Report, p 28

[2] The report on the Supply of Capital Funds for Industrial Development in Europe (Project No 292'), 1957, pp 28 29

[3] Mr Saroj Kumar Basu agrees with this view (*Industrial Finance in India* 1953, p 5)

type of shares termed as deferred shares The said Act has done away with these shares

Preference shares carry a preferential right to dividend and repayment of capital in winding up These may have several categories, viz, (i) simple or non-cumulative, (ii) cumulative, (iii) participating, (iv) non participating, (v) redeemable, (vi) irredeemable, (vii) convertible, (viii) non convertible, etc Amongst the simple or non cumulative preference shares, there are sometimes several subclasses, viz, first preference shares, second preference shares, etc

Legally, all shares other than the preference shares are termed as equity or ordinary shares A large part of the net profits of a company, after paying a fixed dividend to preference shares, if any, is paid as dividend to the ordinary shares In the absence of deferred shares, they are entitled to the whole of the surplus profits A major portion of the authorized capital of companies is always in the form of ordinary shares

Bonus shares are those which are sometimes issued by a successful company to its shareholders in payment of the bonus or additional dividend out of accumulated profits of the past This is by way of capitalization of profits

Debentures also have several classes being categorized on the basis of transferability, security or redeemability The debentures which are registered in the books of the company and are payable to the registered holders who cannot negotiate their holdings, except according to the prescribed procedures are called Registered Debentures The debentures which are not entered in the books of the company and are payable to the bearer thereof are called *Bearer Debentures* They are negotiable instruments

Simple, naked or *unsecured* debentures are those where no security is given to the lender for the payment of interest and the repayment of capital The holders rank as ordinary creditors of the company in liquidation Debentures which are secured by a charge on the assets of a company are called *secured debentures* In case of default the creditors can make good their loss from the assets charged The charge is sometimes fixed or specific and sometimes it is a floating one

Redeemable debentures are repayable after a stated period of time and *irredeemable* ones are not so repayable during the life-time of the company

These various types of shares and securities are issued in order to suit the temperament and taste of various classes of investors Preference shares are generally favoured by cautious investors, who want a guarantee of minimum dividend, but they cannot be regarded as safe as debentures, which enjoy a greater security both of payment of interest and repayment of capital, nor so profitable as the ordinary shares where there is no limit to the getting of gains In prosperous times preference shareholders get nothing more than their fixed dividend unless they hold participating preference shares, while in

times of adversity like ordinary shares they run the risk of losing their entire capital though they are protected to a certain extent due to their preferential right of repayment of capital in the event of winding up The difference between these two kinds of shares is not so much of kind as of degree Though both of them cannot be placed at par preference shares are preferable in times of adversity, while in times of prosperity the ordinary shares are liked most, but neither of them are free from the inherent risks of the industry In practice preference shares appeal to those investors who are willing to make some sacrifice of income in the interest of security and are issued by those companies which are almost assured of their earnings and whose business is not of a speculative nature

The debentures are a very desirable means of raising a part of long term finance as it is economical as compared to shares, the rate of interest being lower than the dividend on shares But it is not considered a sound investment because the holder of debenture bond is not allowed to share in the prosperity of the company and he is only entitled to his pound of flesh No doubt greater prosperity of the company improves the value of his security and enables him to sleep more peacefully but puts not a paisa more income into his pocket However they are preferred by an investor of somewhat conservative nature who is not interested in the prosperity or adversity of the concern Rather he is interested in obtaining regularly his fixed interest out of capital if not out of profits If adverse times come, he must withdraw his money as creditor of the company

Usually it will be noticed that the business community prefers ordinary shares whereby it partakes in the control and the prosperity of the concern , the middle class people (government servants, employees of banks and commercial firms, teachers, doctors lawyers, etc), prefer to invest in preference shares , and institutional investors and other large investors prefer to invest in debentures whereby they are ensured of a safe and fixed return regularly

In India major share of industrial finance is contributed by ordinary shares Mr M A Mulky studied the finances of 597 companies in 1946 in order to find out the relative proportion of different securities in the fixed capital of these companies

Out of 597 companies whose capital structure was examined, 382 companies did not issue preference shares and 579 did not issue debentures, but all of them had ordinary shares Out of the total paid up capital (including debentures) of Rs 151 30 crores Rs 108 53 crores (72%) was contributed by ordinary shares, Rs 30 24 crores (or 20%) by preference shares Rs 1 15 (or 1%) by deferred shares and Rs 1 38 crores (or 7%) by debentures The match industry depends entirely on ordinary shares and the proportion in several other industries is also high For instance, timber has 96% ordinary share capital cement 92%, steamship and tea 90% each and coal 88% Preference shares have been favoured most by iron and steel industry where their percentage share slightly exceeds that of ordinary share capital and by chemical (31%), jute (29%),

engineering and construction (26%), and paper industries (22%). Debentures are not popular in the cotton textile or tea industries. Paper (20%) sugar (15%) and jute (11%) industries have raised a part of their finance in the form of debentures. The above figures relate to the year 1946. The position is not very much different today. The capital raised by joint-stock companies (non-government) during the calendar year 1964 amounted to Rs. 103.71 crores (including bonus shares and loans) wherein the relative proportion of various securities was as follows[1]

	Rs. in crores	*Percentage to total*
Ordinary shares	77.14	74.2
Preference shares	4.42	4.3
Debentures	11.07	10.6
Bonus shares	1.92	1.9
Loans	9.16	9.0
Total	103.71	100

If, however, the issues of Government Companies are also taken into account, the share of ordinary shares is considerably improved, since Government Companies ordinarily neither issue Preference shares nor Bonus shares. The issue of debentures is not also popular with Government Companies. The relative share of different securities of all companies (Government and non-Government) comes to as follows

1964-65	*Rs. in crores*	*% Share*
Ordinary shares	237.53	85.8
Preference shares	4.42	1.6
Debentures	11.81	4.3
Bonus shares	1.92	0.7
Loans	20.96	7.6
Total	276.64	100

Denomination of securities

Denomination or face value of security is also important from the point of view of raising finance. It should be kept at a figure which would appeal to the particular type of investor approached. For example, preference shares are usually preferred by a cautious but small investor, the advantage of keeping the denomination of preference shares low becomes obvious in order to suit the convenience of such investors. Moreover after the abolition of the princely states and the zamindari system and imposition of ceilings on incomes, it is but desirable that securities of small denominations should be issued by industry in India. It is, however, noteworthy that the denominational structure of Indian industry from this standpoint

[1] Reserve Bank of India—Report on Currency and Finance for the year 1964-65

leaves much to be desired There is lack of uniformity and balance The denominational value of securities is found to vary from Rs 0 50 to Rs 2,500 (ordinary shares having 30 different denominations, preference shares 15 and debentures 6),[1] the most popular denominations are Rs 10 Rs 100 Rs 500 and Rs 1 000 as shown below

Popular denominations of shares in India[2]

Name of Share or Security	*Most popular denomination*
Ordinary shares	Rs 10 and Rs 100
Preference shares	Rs 100 and Rs 10
Deferred shares	Re 1
Debentures	Rs 500 and Rs 1,000

After studying the denomination of different securities Mr M A Mulky observes Both the Rs 10 and Rs 100 denominations are within the reach of the small Indian investor but the *Rs 500 and Rs 1,000 denominations which have been favoured for* debentures are definitely outside his reach It is therefore, desirable that the denomination for debentures should be fixed at Rs 100 so as to *enable the small investor to invest in this safe type of* security If ordinary shares of Rs 10 each preference shares of Rs 100 each, and debentures also of Rs 100 each are issued by companies, some uniformity of denomination will be easily obtained '[3]

Traditional agencies of long-term finance

The traditional agencies supplying finance to Indian industry have been (1) investing public, (2) managing agents (3) public deposits, (4) institutional investors (i e , insurance companies, investment trusts, commercial banks, *etc*), (5) self financing, (6) Central and State Governments, and (7) foreign capital

(i) Investing public. The initial finance required by industries *is usually obtained by them in the form of share capital.* A part of the share capital may be taken up by the promoters. directors and their friends, etc Remaining shares are offered to the *public for subscription Additional capital may be found by the* issue of further shares (ordinary or preference) or debentures. During the second World War and for a few years thereafter, *the market for equities was gradually broadening in India,* but in subsequent years it received a set back A glance at the figures relating to the number and paid up capital of joint stock companies at work

1 M A Mulky, *The New Capital Issue Market in India*, 1947, pp 62 70
2 *Ibid*, p 70
3 Between January 1956 and June 1960 of 211 ordinary share issues, 107 issues were of *Rs 10* denomination and *73 issues of Rs. 100* denomination , of 76 preference share issues, 60 issues were of Rs 100 denomination and 13 of Rs 10 denomination , of the 27 debenture issues. *11 were of Rs 1 000* denomination 7 of Rs. 100, and 6 of Rs 500 denomination (Reserve Bank Bulletin, Feb 1961, p 171)

in India since 1939, will indicate that the share market was easy till 1950, but the progress thereafter was rather slow As a result soon after the initiation of the First Five Year Plan it was found that investment in the private sector had not reached the level envisaged in the Plan Consequently the Reserve Bank of India, with the consent of the Central Government, appointed the Shroff Committee[1] in 1954 to examine this question The representatives of industries, stock exchanges and chambers of commerce who appeared before the committee were almost unanimous in their view that it was difficult to raise new capital in any appreciable amounts except, perhaps, for the very best companies Some idea of the progressive deterioration in the condition of the capital market could be obtained from the figures of the consents granted for new issues by the Controller of Capital Issues under the Capital Issues (Control) Act, 1947, and of the actual amounts raised by such companies as furnished relevant returns

It will be obvious, the annual amount sanctioned was Rs 73 crores, whereas the amount of capital actually raised was Rs 28 crores during 1948-52[2] The situation did not change in subsequent years also During the six years 1952-57 the amount of capital sanctioned (and this relates only to reporting companies) was Rs 312 60 crores, whereas the actual amount raised was Rs 198 45 crores, the annual averages being Rs 52 10 crores (sanctioned) and Rs 33 08 crores (raised) respectively[3] The annual average of sanctions for 1951 58 came to Rs 61 6 crores and of the amount paid-up to Rs 33 5 crores only[4]

The situation improved since 1959[5] when there was a spurt in new issue activity and a prolonged boom in the stock market The encouraging public response since 1959, was accounted for by continued import curbs (since 1957) and the growth prospects for industry in the Third Plan[6] The easy conditions of the capital market were, however, of a short duration and lasted till the end of 1962 As a sequel to the declaration of the Emergency in October 1962 and its aftermath including Pakistani attack in August 1965, the capital market received a rude shock and since the beginning of 1963 it has continued to remain subdued[7]

1 The Committee on Finance for the Private Sector 1954
2 Report of the Shroff Committee 1954, p 30
3 Reserve Bank of India Report on Currency and Finance for the year 1957-58, statement 47
4 Reserve Bank Bulletin, Feb 1961, p 177
5 "The high level of new issue activity noticed since 1959, continued during 1962, though towards the close there were signs of some slackening owing to the depressed state of the stock markets Public response to the issues offered on the market, although selective, was generally satisfactory and several equity issues particularly those with growth prospects and backed by foreign participation attracted sizable over subscriptions" (Reserve Bank of India—Report on Currency & Finance for 1962 63)
6 Reserve Bank Bulletin, Feb 1961 p 169
7 For reasons of this slackness in the capital market, see chapter 11, 'The Indian Capital Market'

(2) Managing agents The most important agency providing long-term industrial finance in India has been the managing agents. The agents, besides being responsible for the promotion and management of companies also act as financiers and guarantors of loans. They not only provide block and working capital themselves but are instrumental in obtaining it from other sources in the form of debentures, bank loans and public deposits. By placing securities of companies on the market they perform the functions of the underwriters of issue houses of the west or industrial banks of the continent and in this manner bring together the investor and the industry. This institution has led the country successfully through the industrial development during the last 100 years or so being responsible for promoting, managing and financing almost all the important large-scale industries of the country like iron and steel, jute and cotton textiles, tea gardens and cement etc.

At the time of the discussion of the Indian Companies Bill, 1955 in the Parliament it was disclosed that in 1954-55, out of the paid-up capital of Rs 251 21 crores of 27,779 companies in existence, the managing agents contributed Rs 29 3 crores, being 13 6% of the aggregate paid up capital. As regards loans and advances made or guaranteed by the managing agents, the percentage worked out to about 24. Thus, the total contribution of managing agents came to 37 6% of the paid up capital which represents a substantial share.

Although the managing agency system has rendered yeoman service to Indian industry and forms the basic framework of our industrial financial structure, the system has been abused to a certain extent. Consequently, since the formulation of the Companies Act, 1956, a policy of gradual elimination has been adopted, and Government has taken powers to eliminate it from any industry or business at any time by giving due notice. Under the circumstances, it is desirable that Indian industries should be made less and less dependent financially on managing agents. It must, however, be remembered that a hasty action to abolish the system is likely to create a vacuum in the industrial field and disrupt industry.

The National Council of Applied Economic Research has studied the financial stake of managing agents in Indian industry after the adoption of the policy of their gradual elimination under the Indian Companies Act, 1956.[1] The study reveals that managing agents contribute to the share capital of public limited companies managed by them a minimum proportion of 25 to 35% of the subscribed capital. In the case of large-sized companies more than 70% of the secured bank loans, and in the case of middle-sized companies, more than 50% of such loans, are guaranteed by managing agents. Unsecured bank loans form a small proportion of the total loans of companies, but managing agents guarantee 31 5% of those obtained by large-sized companies and 28% of those obtained by medium-sized companies. Managing agents also act as guarantors for all the credit extended by State Financial Corporations and most

1 *The Managing Agency System*, 1959

of that extended by the Industrial Finance Corporation Fixed deposits are of considerable importance for smaller companies and the personal security and credit of the managing agents ensure a steady flow of deposits from the public After a detailed analysis, the study concludes 'that despite the emergence of state sponsored financial agencies the capital market in India has not yet developed to an extent that would substantially reduce the risk and difficulties of financing the corporate sector , nor has there been any prominent development of specialized institutions for company promotion *Hence, from the institutional angle, the need still exists for a system* that integrates the several functions required for business floatation and operation [1] Thus, managing agents still continue to be an important institution in the effective performance of the private sector

Lately the Managing Agency Enquiry Committee in its Report *(1966) observed "In the present economic context, when the country* is faced with an emergency, when conditions in the capital market are sluggish and when there is particular need for not disturbing the sense of confidence of the private sector unduly, there is much to be said for hastening slowly in reforming the system of industrial management in the country ' Much against the wishes of the committee, the union government has taken the decision to abolish the system after giving three years notice from jute, cotton cement, paper and sugar industries In other industries the position is to be reviewed periodically This does not appear to be a wise step as it will deprive the country of this oldest and an important source of industrial finance

(3) **Public deposits** Public deposits constitute an important source of industrial finance in some of the Indian industries, particularly in sugar, cotton textiles, engineering, chemicals and trading concerns Although public deposits are principally a form of short-term finance, but have since long been utilized to provide long and medium-term finance by cotton mills of Bombay, Ahmedabad and Sholapur and tea gardens of Bengal and Assam largely and by some cotton mills of Bengal and Punjab to a smaller extent The system is a legacy from the old past when the banking system had not *developed adequately and the money was kept for safe custody with* the Mahajans In Bombay and Ahmedabad the men who established the mill companies were either merchants or shroffs in whom the public had confidence, and hence their savings were entrusted to them These deposits are received from the public, the shareholders and the employees of the mills

From the figures collected by the Indian Central Banking Enquiry Committee during the thirties, it will be observed that in Ahmedabad public deposits constituted by far the largest single source (39%) of total finance to the industry and in Bombay contributed 11% of the finance [2] The system worked vigorously

1 NCAER—*The Managing Agency System*, p 137
2 Report of the Indian Central Banking Enquiry Committee 1931, Vol I, Part I, p 278

and well and no complaints were heard either from the millowners, or from the depositors [1]

The position in 1936 was better showing slight lower percentage (10 2) for Bombay and higher (50 9) for Ahmedabad In fact, in Bombay deposits began to be withdrawn during the depression period as people lost confidence in the Bombay cotton companies

The practice at Bombay has been of six or twelve months deposits but at Ahmedabad deposits are for a longer period, usually for a term of seven years The latter therefore is the nearest approach to debenture bonds, and from the point of view of the mill companies even better than debentures, as depositors have no lien on the assets of the companies

The Reserve Bank of India has collected figures for 1957, 1958, and 1959 for 1,001 public limited companies and for 1960-61, 1961 62, and 1962 63 for 1,111 public limited companies and has found that total deposits of companies have gone up from Rs 20 75 crores in 1957 to Rs 33 77 crores in 1962 63 [2] The distribution of these deposits industry-wise is shown below

Deposits from public with public limited companies

(Rupees in crores)

Industry	*1957*	*1958*	*1959*	*1960-61*	*1961-62*	*1962-63*
Cotton textiles	9 98	10 64	10 27	11 90	12 55	13 41
Sugar	2 44	3 16	3 50	2 67	3 05	3 32
Engineering	—	—	—	2 56	2 73	2 86
Chemicals	0 60	0 64	0 72	1 57	2 01	2 28
Trading	0 40	0 56	0 90	1 77	2 73	3 05
All Industries	20 75	23 76	25 10	25 49	29 37	33 77
No of Cos	1,001	1,001	1,001	1,111	1,111	1,111

Deposits from the public were mainly in the form of fixed deposits, the proportion of fixed deposits to the total varying from 65% to 67% in three years (1960 62) The deposits were largely concentrated in sugar, cotton, engineering, chemical and trading companies which together accounted for 75% of total deposits in 1962 63 Acceptance of deposits was fairly widespread among the companies of the cotton textile and sugar industries, more than half the number of companies in the former industry and two fifths of the number of companies in the latter, reported deposits at the end of 1962 63

In relation to total borrowings, however, deposits were small,

1 *Ibid* Vol I, Part II (Minority Report), p 329

2 The Reserve Bank has collected figures of deposits of non banking companies (vide Bulletin July 1965 and November 1966) which show a rising trend of deposits with joint stock companies amounting to Rs 39·66 crores at the end of 1963 64 and Rs 37 47 crores at the end of 1964-65

accounting for only about 4% of total borrowings of all industries taken together as disclosed by the following figures

Deposits as a source of finance (all companies)

Industry	*Deposits as percentage of total borrowings* 1960 61	1961 62	1962 63
Sugar (65)	5 7	5 4	6 8
Cotton textiles (220)	8 6	9 0	7 7
Engineering (155)	2 8	2 6	2 4
Chemicals (76)	5 7	6 5	5 6
Trading (59)	7 8	10 4	10 5
All Industries (1,111)	3 9	4 1	4 3

(*Figures in brackets indicate the Number of Cos*)

Source Reserve Bank of India Bulletin, Aug 1960, June 1961, and February 1964

Taking, however, the individual industries, deposits contributed a substantial share of the total borrowings of companies concerned as shown below

Deposits as a source of finance shown as percentage of total borrowings of companies

Industry	*1960-61*	*1961-62*	*1962-63*
Sugar	13 1	13 0	16 1
Cotton textiles	14 0	14 2	13 2
Engineering	15 3	14 0	12 5
Chemicals	24 0	25 8	18 0
Trading	31 7	29 5	32 7
All Industries	10 9	10 9	12 0

The deposits disclosed a marked importance as a source of finance for cotton textile units having registered office at Coimbatore About one-third of the total borrowed funds of these units was from deposits Other groups in which deposits accounted for a fairly large proportion of the total borrowings were the trading companies of Madras and West Bengal, Sugar companies of the Punjab, engineering companies of Gujarat and Delhi and chemical companies of Gujarat About 30% of the total deposits were held by companies with a paid-up capital over Rs 1 crore each at the end of 1962-63 The practice of accepting deposits appeared to be less widespread among the smaller companies with paid-up capital between Rs 5 lakhs and Rs 10 lakhs each than among the other categories

The system of raising capital by public deposits has been severely criticized In the first place, as a source of finance, the

deposit system is very inelastic and uncertain It may not serve the industry according to its needs and money deposited may be withdrawn at any inconvenient time to the industry It actually so happened in the case of Bombay mills during the period of depression It is therefore termed 'a fair weather friend It is also said to be a costly method of raising loans as compared to bank loans, except in the case of a few larger and well-established industrial concerns or concerns under the management of reputed firms of managing agents It is defective from the point of view of the depositors in as much as the unwary depositors may not be able to judge the soundness of the concern and may deposit his money with unsound concern and thus risk his money The depositors on account of their position as unsecured creditors are also unable to prevent the concerns from overtrading or otherwise in indulging in speculation

There is no doubt that the method has its drawbacks But there can be no denying the fact that the development of the Bombay and Ahmedabad cotton mill industry owes much to the existence of this system In normal times this method of raising money has the advantage of enabling a company to keep its share capital low and to borrow at cheap rate and thus pay higher dividends than would have been possible if the entire money were in the shape of share capital The danger of a run in normal times is not so great as is often made out Depositors in mills are not different from those in banks in their mentality and both are liable to panic and this is a danger which modern financial organization carries with it It may not be the soundest system of financing but it would hardly be fair or reasonable to condemn it categorically specially when it has stood the test of time during the last 30 or 40 years It has proved a blessing to the limited sphere of the industry where it has flourished so far

(4) **Institutional investors.** In the long term capital market a very useful service is performed by institutional investors such as commercial banks, insurance companies and investment trusts These institutions invest part of their surplus funds in shares and debentures of joint stock companies

(*a*) *Commercial banks* The practice of joint-stock banks in India in regard to industrial finance is largely based on the British tradition of commercial banking under which banks as a rule provide only the working capital requirements of industries principally on the security of floating assets and eschew long term advances against fixed assets or otherwise The advances so made to industries come to about one third of their total advances A part of these advances though ostensibly short term, is renewed from time to time Though this part of the finance revolves or rolls over, in actual practice it does serve the needs of providing finance for long periods to a certain extent An *ad hoc* survey of medium term loans granted by banks showed that such loans given to industry on April 27, 1962 amounted to Rs 103 6 crores, forming about 8% of the total bank credit on that

debt Of this, a little over half was medium-term loan proper and the remaining was short term renewed from time to time

Apart from such finance, the commercial banks in India also indirectly partake in long-term industrial finance through (a) purchase of shares and debentures of industrial concerns, (b) making advances against such shares and debentures, and (c) investments in the shares and bonds of the Industrial Finance Corporation of India and State Financial Corporations Investments of scheduled and non-scheduled banks approximate 2% in shares and 1% in debentures of joint stock companies as shown below

Investments of scheduled and non scheduled banks in shares and debentures of companies[1]

	31 12 52		31 12 55		31 12 64		31 3 66	
	Crore Rs	%	*Crore Rs*	%	*Crore Rs*	%	*Crore Rs*	%
Shares	8 19	2 0	8 34	1 7	16 63	1 8	25 61	2 5
Debentures	4 00	1 0	4 66	1 0	26 90	3 0		
Total	12 19	3 0	13 00	2 7	43 53	4 8	25 61	2 5

Thus it will be observed that out of the total annual investments of commercial banks about 3%, are held in shares and debentures of joint-stock companies

(*b*) *Insurance companies*—Insurance companies in India have played an increasingly useful role in the provision of industrial finance through their investments in shares and debentures of well-established companies As on 31st December, 1952, out of the total assets of Rs 292 92 crores, the investments of Indian insurance companies in shares and debentures amounted to Rs 41 79 crores or 14 3% of their total assets Of this amount, debentures accounted for Rs 13 15 crores, preference shares Rs 10 90 crores, and ordinary shares Rs 17 74 crores This level of investment is not in line with that prevalent in other countries where insurance companies invest a larger proportion of their assets in shares and debentures of companies Two reasons are said to be responsible for this low level of investment in India There has been an unhappy experience in the past of a heavy depreciation in the value of such investments Secondly, the restrictions imposed by the Insurance Act have acted to limit such investments It has been urged therefore that the Insurance Act should be modified with a view to raise the limits of investment in shares and debentures The life insurance business was nationalized early in 1956 and since then the investment policy of the Life Insurance Corporation of India which had taken over about 240 companies has been completely revised The investments

1 Compiled from Reserve Bank's Annual Reports under Section 36 (2) of the Banking Companies Act, 1949, entitled *Trend and Progress of Banking in India*

of the Life Insurance Corporation are divided into three broad categories First, Government and approved securities which generally mean gilt-edged securities, secondly, investments approved under section 27A of the Insurance Act, and thirdly, other investments The limitations are that at least 50% of the total funds should be held in Government and approved securities and 50% in approved investments (shares and debentures of companies) The section 27A has been amended accordingly and made applicable to investments of the Life Insurance Corporation of India with a further change that the maximum limits of holdings of the Corporation of ordinary shares of the companies have been allowed to be raised from 10% to 30% of subscribed ordinary capital (with further provision for exceeding this limit with the prior approval of the Central Government) The Corporation has also been allowed to invest in private limited companies with the prior permission of the Government

Trends of stock exchange investments of the Life Insurance Corporation of India during 1957-66 are shown below

Year	*% share of public sector*	*% share of private sector*
1957	77 4	22 6
1958	78 1	21 9
1959	78 2	21 8
1960	78 7	21 3
On 31 3 1966	73 5	19 7

It means about 20% of the investments of the L I C are in the private sector Out of Rs 512 76 crores invested in India on 31st Dec, 1960, Rs 92 05 crores (i e, 18%) was in shares and debentures On 31st March 1966, shares and debentures accounted for an investment of Rs 183 19 crores (i e, 20 4%) out of the total investments of Rs 896 42 crores in stock exchange securities

It is noteworthy that there has been a decline in the proportion of investment in the private corporate sector as compared to the public sector, the decline being from 22 6% in 1957 to 19 7% in 1966 Secondly, a comparison of investment pattern of life insurance funds in India with those in other countries shows that the investment in the private corporate sector is proportionately much lower in India *In 1960, this proportion was 40% in the U K, 44% in the U S A*, 42% in Canada, as against 15% in India [1]

(*c*) *Investment Trusts* An Investment Trust is a joint-stock company which sells its shares and debentures to the public like a corporation and employs the proceeds thereof in the purchase of a considerable number of investments It is a financial institution run for the benefit of its shareholders *It has been aptly described* as 'an agency for the co-operative buying and selling of securities for a group of investors' It enables the individual investor, however

1 NCAER—Capital Market in a Planned Economy, 1966, p 20

small his resources, to obtain the advantages of wide diversification in a single commitment The principal business of the trust is the investment of funds in a varied list of stock, shares, bonds and debentures In spreading out the risks in various classes of securities and several industries and trades, the investment trusts partake some of the aspects of banking and insurance It is thus a useful link between the investing public and those who need capital, i e, the Government, public bodies and joint stock companies

Broadly, there are two types of investment trusts, namely, (1) management investment trusts which are organized and function as companies, and (2) unit trusts which are created under trust deeds which provide, among other things, for the regulation of management in regard to investment of funds and operate purely by virtue of a contract in the form of a trust agreement Management trusts, being organized as companies, are not trusts in the legal sense of the term , it is the unit trust which is really a trust in the strict sense of the term The unit trust has been commended for development in India It has several advantages It is eminently suited for catering to the needs of middle and poorer classes whose individual savings may not be large enough to facilitate direct operations on the stock exchanges Also since each unit represents a fraction of a number of securities, the risk undertaken by an investor in a unit is spread over a number of securities and is thus minimized It is also advantageous in as much as the actual operations of buying and selling securities are conducted by the specialized management company on behalf of the unit holders In view of these advantages, such institutions are particularly suitable in India where, in order to increase capital available to industries, small savings have to be drawn into the investment market

The investment trusts, while of recent growth in India, have long been known in Europe and other countries of the West The first investment trust formed in India in 1933 was *the Industrial Investment Trust Ltd* founded by the well known firm of brokers, Messrs Prem Chand Roy Chand & Sons of Bombay *The New India Investment Corporation Ltd* and *Bird's Investment Ltd* were registered in Calcutta *in 1936* and *the Investment Corporation of India Ltd*, *in 1937* During subsequent years particularly the war years, a number of such trusts came into being, but their number is very small The establishment in December 1963 of the U T I in the public sector fulfils a long awaited demand of the country

According to a study[1] of the Reserve Bank of India, the total number of both public and private limited investment and trust companies in March 1959 was 595 with paid up capital of Rs 37 3 crores At the present time *India needs most the services of such institutions for mobilizing small savings* and investing them in shares and securities of diversified type of industrial ventures The large investing classes have disappeared or are disappearing fast with the

1 Published in the Reserve Bank of India Bulletin, October 1960

imposition of ceilings on incomes and it is the small investor who can serve industry through investment trusts.

The Reserve Bank has in its study suggested the broad lines on which unit trusts can be organized in India. It states that some of the more prominent industrial houses, firms of brokers and insurance companies would seem to be the appropriate agencies to organize and sponsor unit trust in India. The possibility of some of the existing well run investment trusts organizing unit trusts or converting themselves into unit trusts is also suggested; the availability of suitable blocks of portfolio securities and investment experience accumulated over a long period of time are points mentioned in their favour.

In a scheme for the promotion of unit trusts tax concessions have a significant place. In spite of super tax concession, the few relatively large investment trust companies in India, which function on the lines of true investment trusts were not able to provide sufficient attraction to the small investor in the matter of returns offered as well as capital appreciation. There is therefore a strong case for the exemption of the trust income from tax. Looking to the safeguards and protection to the investor, a measure of regulation of the unit trusts in India is also proposed. The Investment Company Act, 1940 in the U.S. and the Prevention of Fraud (Investments) Act, 1939 in the U.K. are mentioned as useful guidance in this regard. Since at present the investment and trust companies in India are organized and function under the Companies Act a separate piece of legislation is considered essential.

(5) **Self financing**. The term 'self financing' refers to the retention of profits in the business by business concerns and is sometimes also termed as ploughing back of earnings. Self financing or reinvestment of a part of the profits is ideal method of financing expansions and improvements as it raises no complicated problems as does borrowing either from banks or from the public. The reserves which have been built up during a continuous spell of prosperity by following a conservative dividend policy can be used as working capital with great advantage to the concern. This method is also the cheapest one. Self financing has been a great factor in building and expansion of British and American industries. In Great Britain about 40% of the income of industrial companies was retained as depreciation allowances and undistributed profits during the years 1950-51 to 1952-53. In Germany undivided profits varied between 25.4% to 52.6% of gross earnings during 1949-53 period, in France the percentage of retained profits to gross fixed capital formation was between 43% and 50% during the years 1952-55. In Belgium retained profits are the most important source of industrial capital in that country. For small and medium sized companies for which access to the capital market is difficult and costly, self financing has been almost the only source of long term capital. In Greece also the major part of industrial finance is provided by retained profits.

The position of Indian industry was not very much different till 1950-51, when retained profits formed a significant part (40%) of financial resources of Indian industry. But the situation has changed recently. The following figures show industrywise position in this respect.

Retained profits of selected companies

(Percentage of profits before tax)

	Industry	*Taxation*[1] *Inquiry Com (1946-51)*	*Reserve Bank's studies* 750 *Cos*[2] *(1951-55)*	1333 *Cos*[3] *(1961-64)*	*(1963-64)*[3]
1	Cotton Textiles	49.7	23	19.6	9.2
2	Jute Textiles	26.8	17	—6.0	18.8
3	Other Textiles	41.8	2	20.3	26.4
4	Iron and Steel	40.4	65	40.1	43.5
5	Engineering	43.7	53	12.4	19.7
6	Sugar	42.7	41	4.6	9.5
7	Chemicals	33.3	1	27.6	23.7
8	Paper	52.7	55	22.9	28.5
9	Vegetable Oils	36.5	—	10.4	—3.7
10	Matches	51.2	28	12.6	9.9
11	Cement	27.3	39	12.2	16.4
12	Tea Plantations	31.3	37	4.9	3.9
13	Other Plantations	33.3	37	7.5	14.3
14	Coal	35.4	33	20.2	33.8
15	Electricity	22.0	22	28.0	29.9
16	Shipping	29.5	53	24.5	27.1
17	Others	43.9	—	—	—
	Total	40.1	39	20	18.8

There has been a sharp fall in the retained profits of industry in recent years. The study of finance of 1333 public limited companies shows that retained profits formed only 20% of the financial resources of companies during the four years 1960-61, to 1963-64, the retained profits for the year 1963-64 being only 18.8%. In the case of Iron and Steel industry the retained profits were as high as 65% of the financial resources during the period 1951-55, but they declined to 43.5% in 1963-64. In shipping retained profits formed 53% of total resources during 1951-55 period, but were only 27.1% in 1963-64.

This declining trend of retained profits is due to two reasons. *Firstly, the interest charges have been claiming an increasing proportion* of gross profits from year to year. Secondly, the tax provision as a percentage of profits before tax has also shown a rising tendency,

1 Report of the Taxation Enquiry Commission, 1953-54 Vol. I, pp. 316-17

2 Reserve Bank Bulletin, October 1958

3 Reserve Bank Bulletin, November 1965

having risen from 38.8% in 1960-61 to 52.8% in 1962-63. The industry should be saved from this situation.

(6) Central and State Governments The industrial policy of India till the first World War was based on the English economic philosophy of *laissez faire* and thus Government kept itself aloof from the industrial field. But under the enormous stress of the war, the doctrine of *laissez faire* broke down and the theory that interference by the state in the economic life of the country was injurious to its well-being came to be discarded. The Indian Industrial Commission which examined the question of industrial development of the country under the changed circumstances of the time recommended *inter alia* that the state should play a definite role in the financing of industry. It suggested direct financial assistance in the form of loans or of plant and machinery on the hire purchase system to small or cottage industries and of guarantee of dividend of new companies and of loans to going concerns, of taking up of securities, both shares and debentures of large-scale industries of national importance. The Central Government did not act up to the expectations of the Commission. It satisfied itself by merely rendering indirect assistance in the form of discriminating protection to industry. Some of the State Governments, however, did realize their responsibility towards the industrial development by direct assistance and they passed State-Aid to Industries Act or framed rules for the purpose. The following measures were adopted by various states during the inter-war period:

1. The Madras State-Aid to Industries Act, 1922.
2. The Bihar and Orissa State-Aid to Industries Act, 1923.
3. The Bengal State-Aid to Industries Act, 1931.
4. The Central Provinces State-Aid to Industries Act, 1934.
5. The Punjab Industrial Loans Act, 1923.
6. The Bombay Government framed Rules in 1925.
7. The United Provinces framed Rules in 1921.
8. The Mysore Government framed Rules in 1913.
9. The Department of Commerce and Industries began to assist industries in Hyderabad in 1918.
10. Baroda began State-Aid to Industries in 1891.
11. Gwalior and Travancore also had such rules.

The assistance under these acts and rules was provided in the form of loans, guarantee of loans raised from banks, grant of raw material and land at favourable rates, supply of machinery, guarantee of minimum return on shares and debentures, etc. The period of loans generally varied from 10 to 20 years.

Though considerable sums of money were advanced to industries under these provisions, the results were rather disappointing and people began to believe that the very principle of financial assistance to industry by the Government was wrong. The failure, however, of the working of the system was not due to any inherent

defect of the system itself but due to its wrong handling The primary reason of its failure was the lack of experience of the Departments of Industries and proper planning Enormous sums were advanced as loans to certain weak concerns which failed soon after and the recovery was impossible or only partial in many cases

Bureaucratic delays in the disbursement of loans had in no small measure contributed to the disappointing results The most important cause of failure was the absence of a suitable machinery to disburse the loans after careful investigation The uncertainties in interpreting certain sections of the Acts, the lack of co-ordination in industrial policy between the Provincial and Central Governments and initiation of these measures at an inappropriate period of severe economic depression were other important reasons for the failure of these efforts

During the period of the second World War and thereafter conditions changed altogether, particularly after independence , and the Central as well as State Governments had to adopt a more vigorous programme of industrial assistance and finance Under the principles of welfare state and the planned economic development with an ultimate goal of establishing a socialistic society the Government has emerged as an entrepreneur and industrialist Now there are two separate sectors of industry—a public sector and a private sector In the public sector the state is the sole supplier of entire finance But the state assistance continues in the private sector also The assistance provided during 1951-52 to 1953 54 to private industry was as follows

(Rupees in lakhs)

Type of finance	*Central Govt* 51-52	52-53	53-54	*Part A States* 51-52	52-53	53-54	*Part B States* 51-52	52 53	53-54
Investment in shares	—	25	108	128	186	210	530	26	157
Loans	310	274	827	156	280	266	77	90	42
Grants-in-aid	90	17	9	6	30	22	—	2	—
Total	400	316	944	290	496	498	607	118	199

The budget provisions for subsequent years in respect of industrial development in the private sector are as follows

(Rupees in crores)

	Central Government	*State Governments*
1950 51	8 90	5 81[1]
1955-56	11 07	7 07
1960 61	91 27	15 49
1965-66 (Revised)	131 40	48 20

[1] Figure for 1951 52

(7) Foreign capital Foreign capital combined with skill and enterprise is essential for the development of economic potentialities in backward and under-developed regions India owes *not a little* to foreign capital for her industrial development in the initial stages of her economic revival Whatever industrial development took place in India till the first World War was largely due to foreign capital and foreign enterprise In the absence of foreign capital during the nineteenth century there should have been neither the railways, jute and tea plantations and coal mining industries, nor the banking and insurance facilities The modern technique came to India as a handmaid of foreign capital which is primarily responsible for the present industrial status of India Even today we look to the foreign technicians for all advanced type of industrial and economic activity assisted by foreign capital whether it comes from Russia Germany, Canada, Japan Britain the United States, Romania or any other country of the world

No accurate estimates of foreign capital invested in India prior to 1948 are available It was for the first time estimated by the Reserve Bank of India that the foreign capital invested in India was of the order of Rs 255 83 crores in 1948 Since then the figure has been rising from year to year and has more than doubled itself as is shown by the following figures

Outstanding foreign investments in the private sector[1]

(Rupees in crores)

End of June	*Total*	*of which from* *Private sources abroad*	*of which from* *Official sources abroad*
1948	255 8	255 8	—
1953	392 0	392 0	—
1955	456 1	453 4	2 7
1956	493 0	478 2	14 8
1957	543 0	496 1	46 9
1958	572 6	500 4	72 2
1959	610 5	511 5	99 0
1960	690 5	566 4	124 1
1961	680 0	581 0	99 0
1962	735 5	625 5	110 0

Foreign investment, in its wider sense, covers all foreign creditor and investor capital received from both private and official sources abroad by the private and official sectors in the country It would, thus, cover short term borrowings medium term suppliers credits and long term investments The trends in foreign capital inflow in the above table refer mainly to the investment of long term foreign capital in the private sector (other than banking) From a limited angle, long term foreign investments in the private sector are

1 Reserve Bank of India Bulletin May 1961, October 1962, and April 1966.

the aggregate of (a) net foreign liabilities of branches of foreign companies operating in India, (b) foreign held shares including proportionate free reserves, and foreign-held debentures of rupee companies, and (c) long-term loans obtained by these companies from official institutions abroad

During the four years ended 1959, net inflow of foreign capital amounted to Rs 153 crores For the five-year period, 1956 60, roughly corresponding with the Second Five Year Plan period, the total net inflow of foreign capital in the private sector is estimated at about Rs 200 crores [1]

Industrywise break down of foreign business investments in India

(Rupees in crores)

	1948	*1956*	*1959*	*1960*	*1962*
Manufacturing	70 7	147 6	250 7	289 4	327 4
Services	99 1	130 3	131 2	135 5	130 8
Petroleum	22 3	116 4	120 7	152 4	154 0
Plantations	52 2	87 9	95 1	99 5	110 3
Mining	11 5	10 8	13 0	13 7	13 0
Total	255 8	493 0	610 7	690 5	735 5

Manufacturing group includes metals and metal products, foods and beverages, chemicals, textile products, electric goods and machinery, transport equipment, etc The largest amount invested since independence has been in the petroleum refining industry wherein investment rose from Rs 22 3 crores in 1948 to Rs 154 0 crores in 1962 Second in importance comes the manufacturing field wherein foreign capital rose from Rs 70 7 crores to 327 4 crores during the same period

The United Kingdom has contributed the largest amount of Rs. 482 8 crores followed by the United States with Rs 108 9 crores outstanding in 1962 as shown below

Countrywise foreign business investments

(Rupees in crores)

Country	*1956*	*1957*	*1958*	*1959*	*1960*	*1962*
United Kingdom	392 5	398 8	398 8	400 1	446 4	482 8
United States	47 0	57 5	60 0	82 0	112 7	108 9
I B R D	14 8	46 9	72 2	83 0	78 1	—
Switzerland	8 2	6 7	6 8	7 6	8 9	10 8
West Germany	2 8	3 5	3 8	5 4	6 8	12 0
Japan	0 2	0 6	0 6	1 4	3 4	3 3
Pakistan	4 2	4 2	4 2	4 2	4 2	—
Others	23 2	24 8	26 2	27 0	30 0	117 7
Total	492 9	543 0	572 6	610 7	690 5	735 5

1 Reserve Bank of India Bulletin, October 1962, pp. 1531-44

The International Bank's contribution has been in the form of loans. A large part of these loans have been employed in the iron and steel industry and power projects. The Industrial Credit and Investment Corporation of India has also utilized loans from I.B.R.D. The private sector has also received loans from other official agencies such as the U.S. Export-Import Bank and the Development Loan Fund (D.L.F.). Besides there have been drawings from Britain for the Naharkatia oil fields pipeline project and the Japanese yen credit. Loans from the U.S. Exim bank and D.L.F. as well as from Japan have been spread over a larger number of manufacturing industries including textiles, machinery and machine tools, electrical goods, transport equipment, chemicals, cement, etc.

The basic policy of Government of India in regard to foreign investments remains the same as it was announced in 1949. According to this policy no distinction is made in native and foreign capital for the purposes of industrial development in the country. The Government allows earning of profits by foreign investors and taking them home, if they like, subject to the foreign exchange position in the country. The Government of India is also committed to pay compensation in case of nationalization of industries having foreign capital employed in them. Thus, the general policy of the Government is to encourage foreign investments. However, the goal of socialistic pattern of society has created a fear in the minds of the foreign investors. Consequently, the Government has, in recent years, provided inducement by granting concessions. The tax exemptions have been enlarged; there has been a modification in the tax payable by companies in respect of dividends received by them, as a result of which the rate of super-tax on dividends on inter-corporate investment whether Indian or foreign, and whether on a majority or a minority basis, has been fixed at a uniform level applicable to investment in companies formed after March 31, 1959; taxation on royalties received from Indian enterprises by foreign companies has been reduced from 63% to 50%. The measures should help improve further the climate for foreign investments in the country.

9

Long-term Finance in India

(New Agencies)

The question of large scale industrialization of a country is closely related to the provision of adequate long term finance. Whenever India has embarked upon any ambitious schemes of industrialization, the question of finance has come to the fore front. And whenever the question of long term industrial finance has been considered, the services of commercial banks have been questioned. People have blamed banks for not providing long or medium term finance to industry. *In fact, in no country have the relations between* banking and industry been satisfactorily settled.

In India, the chief sources of long term finance have been the managing agents and the investing public. The banking system, having been founded on British model, has helped the industry to meet the needs of short term finance only. The investing class in India *has not yet developed to the desired extent. Sometimes the shyness* of the people, sometimes bank failures, sometimes company liquidations, sometimes threats of nationalization, and sometimes other policies of the state have retarded the progress of capital formation in India and have increased the proverbial shyness of capital rather than encouraged it. Under these circumstances, the managing agents rendered yeoman service to Indian industry up to the time of the first World War. But soon after, the system came in the grip of numerous abuses and the public opinion grew very critical of the undesirable activities of the managing agents. *It was pointed out* that industry should be made less and less dependent on managing *agents for its financial needs*[1] The confidence of the people in managing agents was shaken. It was contended that wherever they (managing agents) existed they were responsible for the weakness of the industry, which no financial measures could overcome[2] In many

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[1] The Indian Central Banking Enquiry Committee, Vol I, Part I (Minority Report), p 280

[2] *Ibid*, Part II, p 332

cases the finance provided by *managing agents proved inadequate*[1] and the industry was compelled to look to the banks or other sources available to overcome the crisis Thus not only was the finance provided by managing agents inadequate it was unsuitable also It was considered desirable that direct friendly relationship should be established between industrial companies and banking system[2] It was generally held that close intercourse between banks and industries created an atmosphere of mutual confidence with resultant benefit to both the parties While suggesting this close co operation between banks and industry, people had in mind the German system of banking We realize that that is the secret of the German Banking policy in respect of industries' Thus ran the evidence tendered before the Central Banking Enquiry Committee[3] The Committee therefore recommended that such of the existing commercial banks as were well established and carried on their ordinary banking business on the safest and soundest lines might follow the German system and it called upon the Imperial Bank of India (now the State Bank of India) to give a lead in this direction

Certain people commended *Japanese system* of Banking and others found a remedy of the problem of long term industrial finance in setting up a *special type of industrial bank* or barks to finance industrial concerns Then there were other suggestions viz., the establishment of (a) an All India Industrial Corporation and a Provincial Industrial Corporation in each Province, (b) an Industrial Mortgage Bank on the Swedish General Mortgage Bank model Some of these systems may be discussed here briefly

The German system

The chief characteristic of the German system of banking has been its close connection with industry as against that prevailing in India, Britain, or other capitalist countries This connection arose firstly out of the current account maintained by an industrial firm with its bank This current account was distinct from the current account as used in relation to banks and their clients in England or in India In the ordinary current account relationship the customer is sometimes in debt to the bank and sometimes has a balance to his credit Many claims thus arise on both sides which are not settled individually but are settled periodically, usually every six months

1 'It has also been pointed out that this Managing Agency system works well when everything goes on smoothly and when the industries are prosperous. During these periods of prosperity if more money is required by the industrial concerns, the Managing Agents may very often continue supplying the money themselves to a considerable degree Later on however when conditions alter and the industry or the particular concern comes up against bad times and the Managing Agents find themselves compelled to find more money to support the industry, it is found that they are not able in all cases to cope with the requirements (The Indian Central Banking Enquiry Committee, Vol I, Part I, pp 279 80)

2 The Indian Central Banking Enquiry Committee, Vol I Part I p 280

3 *Ibid.*, p 297

On the contrary, the current account advances were used by the average German firm not only for the purpose of providing itself with working capital but also for supplying block for extension in anticipation of recourse to the investment market The *industrial current account* was the pivot of all transactions between banks and industry, promotion and issue transactions, direct participation in industrial undertakings and co operation in management through boards of supervisors

The second important connection arose in the matter of promoting companies and equipping them with capital After the plans for the formation of a new company had been prepared and approved by a bank, a 'consortium' (a sort of temporary association of banks and private persons) was formed The promoters (members of the consortium) took over the entire capital in the first instance with the intention of placing it on the market subsequently Whenever industrial companies wished to procure new capital, whether from existing shareholders or by issue of new shares or debentures in the general market, they arranged the transaction with the bank with which it was in permanent banking relations Thus, the banks played the part of middlemen only , they simply held the securities for some time and the lasting participation in industrial undertakings was never their general policy

The third important connection arose in having banks' representatives on the board of supervisors of the industrial undertaking This board came in between the Executive and the general meeting of shareholders and exercised considerable influence over both It was not identical with the British Board of Directors , it was a Board of Supervision and not of Direction

The sympathetic attitude of banks towards industry in Germany and the intimate relationship between the two was a historical necessity About the middle of the nineteenth century when Germany sponsored schemes of industrialization in competition with Britain there was scarcity of capital and in order to assist national industry German banks had to undertake granting long term loans and promotion of joint-stock companies Secondly, whatever capital was available, it was generally misdirected "Those who had the necessary funds were neither willing nor fitted to become progressive entrepreneurs themselves, nor would they entrust their money to others who had the required qualities" Hence there was need of agency which could win the confidence of the investing classes and direct the capital towards sound industrial undertakings The banks filled this gap

It must, however, be remembered that German banks were not unmindful of the dangers of locking up short-term advances They were fully alive to the dangers of extensive and permanent participation in the concerns which they brought into existence They worked on the principle that it was their function "not so much to call great branches of industry into existence through large-scale participation on their own account as to induce the

capitalists of the country, by the authority of their recommendations, to apply idle capital to undertakings which, properly planned according to real needs and equipped with expert management, offered prospects of reasonable profits" Their ability to assist in the promotion of new undertakings, or in the conversion of private into public limited companies, was always subject ultimately to the responsiveness of the capital market If the public were unwilling to put up the new capital required by the industrial company, banks would not take the place of the public and would not themselves furnish the industrial company what the investing public was not prepared to provide The banks were always anxious to place their securities with the public as quickly as possible, and not to hold them in their own hands Contrary to the common belief, lasting participation in industrial enterprises had not been part of the general policy of German credit banks

Besides this, the secret of German banking was the method of self balancing each line of activity The short-term deposits were used for short-term credits and long term loans were based on such resources as could safely be locked up for long periods The total of liquid assets was almost invariably covered by the capital and reserve resources of the bank Even when a certain amount of 'locking up' of depositors funds became unavoidable, the risks were mitigated, firstly, by diversifying their interests and, secondly, by maintaining secret reserves These banks, in fact, had vast resources, large reserves and elaborate and methodical organization which gave them power and strength

None of the characteristics of German banking could be claimed by Indian joint-stock banks They are small banks with inadequate resources and therefore in spite of all tall talk in this direction Indian banks could not walk on the foot prints of German banks Secondly, their deposit assets, which consist largely of customers' deposits liable to be withdrawn at short notice, cannot obviously, without incurring serious risks, be locked up in long term loans or advances to industry Thirdly, the necessary technical and entrepreneurial ability, which is required if mixed banking policy is to be successful, is still lacking among our bankers The large number of bank failures from time to time since the first World War does not offer much hope for this type of banking in India Even the largest of the Indian commercial banks are not suitable for this type of activity

Moreover, the German system came to grief during the depression of nineteen thirties and was modified substantially in subsequent years Following the crisis of 1931 and a complete break-down of the German banking system, a Commission of Investigation was set up in 1934 and, later, a new law, the German Credit Act of December 1934, was passed Under this Act, banks were called upon to maintain a fairly high standard of liquidity and to limit their holdings of real estate and speculative investments Permanent participation and investment in property and buildings were not to exceed the capital and reserves of the credit institution concerned There was a

programme of currency and credit reform carried out in 1948 to suit the requirements of post war industrial *reconstruction whereby the* Bank Deut Scher Laendar acquired extensive regulating powers over all banks Two specialized institutions (K F W in 1948 and I K B in 1949) for providing long term industrial finance were also set up Thus, this whole idea has remained only of theoretical importance for India

The Japanese system

Throughout the nineteenth century, the French Credit Mobilier, a specialist institution for providing industrial finance, attracted considerable attention It provided a great attraction to all those countries which were desirous of achieving rapid industrial progress, and Japan chose it as the model, when she founded her Industrial Bank in 1902 It was the result of the efforts of Prince Matsukata who enunciated the principle that distinct groups of banks should be *established to fulfil different functions* [1] *Till the close of the first* World War the Japanese Industrial Bank served as a model of specialized bank designed primarily to finance industry During the inter-war period, therefore, when India embarked upon her industrialization it naturally attracted considerable notice in India It impressed the Indian Industrial Commission of *1916* profoundly and it was mainly responsible for popularizing the idea of forming an 'industrial bank' in India on the model of the Japanese institution *It inspired many Indian witnesses who appeared before the Banking* Enquiry Committees (Central and Provincial) It was naturally favoured by Indian economists and publicists

*The Industrial Bank of Japan was established with a Govern*ment subsidy under Government control with a 50 year charter, the renewal of the charter being at the option of the Government The Government undertook to guarantee a 5% return on the bank's shares for the first five years, provided the amount of the subsidy did not exceed 5% *of the paid-up capital It was put under the direct* superintendence of the Finance Minister who was to appoint a Comptroller to supervise the business management of the Bank

The Bank is a Joint Stock Company The President and the Vice-President of the Bank are appointed by the Government from among the shareholders owning more than 200 shares in the Bank *Their term of office* is five years The Directors are appointed by the Government from among the members holding more than 100 shares in the Bank and elected in *the general meeting of shareholders* Their tenure of office is three years

The business of the Bank is as follows

(1) To make loans on the security of national bonds, municipal loan bonds or debentures and shares of companies

1 *Accordingly after founding a Central Bank and an exchange bank he turned* his attention to the starting of banking institutions to facilitate the grant *of long term loans to industry and agriculture Thus came into existence* the Hypothetic Bank for agricultural credit, and the Industrial Bank for *industrial finance*

(2) To subscribe for and underwrite national loan bonds, prefectural and municipal loan bonds or debentures of companies

(3) To receive deposits of money on fixed, current or special account and undertake the custody of goods entrusted to it for safe keeping

(4) To undertake trust business relating to secured debentures.

(5) To discount bills

(6) To buy and sell clean and documentary bills of exchange

(7) To make loans on mortgage of estates created by virtue of special laws

(8) To make loans on mortgages of land and buildings belonging to factories

(9) To make loans on mortgages of ships including those under construction

(10) The make loans on the security of ship building materials or equipments

(11) To float national loan bonds, prefectural and municipal bonds and companies' shares and debentures and to receive payment for the same

(12) To make loans on mortgages of lands and buildings in cities and towns designated by Imperial ordinances.

(13) To subscribe for or accept shares of companies.

It will be seen from the above that this is a mixed banking institution with a preponderance of issue and mortgage business. It combines the functions of an issue house with those of a mortgage bank. Although it is claimed to be essentially a monetary institution for industry, it cannot be characterized as a pure industrial bank in the sense that it is interested exclusively in industrial issue or mortgage business. For, in addition to its industrial business it frequently floats and underwrites Government and Municipal loan bonds. It also engages itself in commercial banking business such as the discounting of bills and the receiving of deposits

On a careful study of the structure and operations of the Japanese institution, it was found that such a bank would be unsuitable for India as the conditions were different in the two countries. The loans granted by the Bank are not truly long-term ones and there is no statutory provision for amortization, except for ship mortgage loans It was felt that an institution furnishing such type of industrial loans would not fulfil the real need in India for long-term industrial finance Besides, a mixture of various kinds of banking functions was not considered desirable The experience of Japan did not, therefore, afford a conclusive lesson for India.

Industrial banks

Although banks in India have generally confined themselves to the provision of working capital, there have been at least three

distinct periods in the banking history of the country when Indian joint-stock banks showed a remarkable tendency towards the long-term financing of industry The first such attempt was made by a number of commercial banks, mostly in the Punjab, during the Swadeshi Movement of 1906 13 Industries, started under the new spirit of Swadeshi Movement were intended to be financed by these industrial banks The whole country was swayed by a desire to foster the indigenous industries and the new joint-stock banks undertook to provide long term finance to industry These banks subscribed to the shares and debentures of industrial companies and freely advanced considerable sums on the security of factories, machinery, plant, buildings, etc The more prominent among these banks were the People's Bank of the Punjab, the Indian Specie Bank, the Hindustan Bank, the Lahore Bank, The Doaba Bank, the Marwari Bank, the Industrial Bank and the Credit Bank of India A large number of these banks failed during the financial crisis of 1913-15 Their failure is attributed to the fact that they advanced money recklessly to industrial ventures which did not pay "Frenzied speculation and imprudent and reckless loans" characterized the activities of these banks Every known principle of investment banking was violated

After the first World War, again, certain industrial banks were floated for the specific purpose of promoting and making long-term advances to industries During the war-end boom, there was an outburst of company floating activity and the opportunity was seized upon, as in the Swadeshi period, to establish 'banks' for financing indigenous industries The feeling of forming 'industrial banks' spread very rapidly and developed into a craze for such banking "They became the fashion of the day, the vogue of the times and for some time one heard nothing but of industrial banks, which made their *debut* in the North and South, the East and West "[1] Notable among these banks were the following

	Name of the Bank	*Year of Registration*
1	The Tata Industrial Bank	1917
2	The Calcutta Industrial Bank	1919
3	The Indian Industrial Bank	1919
4	The Industrial Bank of Western India	1919
5	The Central Travancore Industrial Bank	1919
6	The Mysore Industrial Bank	1920
7	The Gundulpet Industrial Bank	1920
8	The Karnani Industrial Bank	1921
9	The Simla Banking and Industrial Company	1921
10	The Raikat Industrial Bank	1922
11	The Luxmi Industrial Bank	1923
12	The South Malabar Industrial Bank	1929

[1] Indian Central Banking Enquiry Committee Vol II, p 192

The Tata Industrial Bank was the earliest and the largest of these Industrial banks It was set up in 1917 with an authorized capital of Rs 12 crores At the outset it showed signs of good prospects and within a very short period its shares were quoted on the Stock Exchange at a premium of Rs 100 Besides the head office, it opened two branches in Bombay and twelve in other centres, viz., Aminabad, Asansol, Calcutta, Chandausi Delhi, Dhanbad, Hapur, Hyderabad, Kanpur, Lucknow Madras and Rangoon

The Bank however, did not confine itself to industrial business solely It undertook to combine the business of exchange banking, commercial banking and industrial banking at the same time Within a short time large sums of money were locked up and had to be written off ultimately In 1922 the authorities of the Bank had to close the Industrial Deptt In 1923 the Bank amalgamated with the Central Bank of India and went into voluntary liquidation The high hopes entertained about the Bank failed to materialize The chief cause of its failure was lack of proper planning in regard to varied type of its activities Long term operations were financed out of current and annual deposits The Bank never made any attempt to issue debentures The policy of the Bank to retain permanently a considerable holding of shares in the companies in which it was interested was misconceived The investments of the Bank were neither properly planned nor wisely selected. The Management was ignorant and inexperienced generally.

After a hectic career lasting 3 or 4 years, most of the other industrial banks were caught in the slump following the first World War and disappeared like the Tata Industrial Bank The chief reasons of their failure may be summarized as follows (1) The establishment of these so-called industrial banks was a deliberate attempt to transplant the German model on the Indian soil But there was confused thinking about the true nature, their constitution and functions in the minds of our countrymen Contrary to the German practice, these banks were primarily deposit banks but indulged in investment banking Pioneers of industrial banks in India could not appreciate the principle of self-balancing followed by German banks The latter had, as a rule, employed their long term funds only in industrial investments Moreover, permanent participation in industry had never been the policy of the banks in Germany (2) Generally the managerial personnel were inefficient and selfish in India The loans made by the banks usually included those advanced to firms in which directors were interested as partners and in a good many cases those that were quite unsecured. No scientific investigation of the affairs of the borrowers was undertaken before advancing loans The bonafides of the directors were also doubted in many cases (3) Lack of necessary knowledge and experience was also an important reason of their inefficient working. Besides, they were not adequately equipped for industrial financing. (4) The investments were neither wisely selected, nor properly diversified Every description of banking was undertaken and very little regard was paid to basic principles of commercial or investment

banking Safety of investment was sacrificed for high speculative *return and frenzied speculation* became a part of their activity in many a cases

Again during the years of second World War a *number* of new banks came into existence to finance industrial activity of the country In view of the war expanded liquid resources of commercial banks and the loss of the traditional sources of their income, they were urged to forge closer links with industry The experience, again, was an unhappy one The failure of a large number of these banks, *particularly in* West *Bengal*, was attributed, among other *reasons, to their long term advances to industrial concerns* [1]

Thus, the results of mixed banking whenever pursued in this country proved disastrous The Central Banking Enquiry Committee had suggested the formation of Provincial Industrial Corporations but could not work out the details for their constitution, functions and working, etc Hence the idea could not take a practical shape Thus most of the foregoing suggestions were either found to be *theoretically unsound or were of little practical value The remedy* of the problem of long-term industrial finance had therefore to be sought elsewhere

Specialized institutions

Special institutions and organizations for financing agriculture have existed on the continent of Europe for many decades But the banks took care of the capital needs of industry A *public capital market grew up beside them in most of the European countries*, but without displacing the banks from their leading role in industry at large This picture was greatly affected by the great depression of the 1930's With few exceptions the resources of the commercial banks were strained to the utmost, not only medium and long term loans, but many self-liquidating advances became frozen , *and credit mobilization facilities were gravely impaired In most of* the West European countries the public authorities had to step in to prevent the failure of the banking system As a result, a number of specialized institutions sprang up to fill the gap in the field of industrial finance These catered exclusively or mostly for the long and medium term requirements of industry The Industrial Mortgage Banks of Finland, *Hungary and* Saxony *and the* National Economic Banks of Poland were typical examples of such institutions Those in Finland and Poland were formed in 1924, in Saxony in 1925 and in Hungary in 1928 With the rise of highly industrialized systems on the continent and in America, a feeling also grew in England that her former policy of *laissez faire* would not ensure her prosperity *in a crowded and increasingly competitive world Consequently, the question* of finding new and up-to-date agencies of industrial finance attracted the attention of businessmen and financiers in England also As a direct sequel to this feeling, there came into exis-

[1] The Report of the Committee on Finance for the Private Sector, 1954, p 48

tence certain specialized institutions of industrial finance viz. (a) the Securities Management Trust a subsidiary company formed by the Bank of England in 1929 to assist the process of rationalization and reconstruction in industry (b) the Bankers Industrial Development Company a private company set up in 1930 with the Governor of the Bank of England as Chairman and (c) the Credit for Industry Ltd launched in 1934 mainly to provide capital for plant and other purposes for small and medium sized businesses These three institutions played only a limited part in promoting industrial ventures the gap in the financial machinery for meeting the requirements of small and medium industries could not be fully bridged by them. The gap was filled by the establishment of two new institutions in 1945 These were the Industrial and Commercial Finance Corporation and the Finance Corporation for Industry Ltd

Secondly it is a well known fact that one of the casualties of World War II was individual capitalism The result is that individuals owning large capital are rarely to be found even in such countries as the U.S and the U.K The entrepreneurial class with capital is fast disappearing though entrepreneurial skill is there With egalitarian idea rapidly spreading savings have become diffused over a wide range of population and they can be gathered only through certain institutions commanding confidence of the people in general Moreover with individual entrepreneurial capital fading into oblivion the need has arisen for special institutions to sponsor new industries requiring large investments and to provide the long term capital needed by existing industries for expansion and modernization Financial institutions thus have assumed some of the responsibilities previously shouldered by individual entrepreneurs and financiers Besides the two institutions formed in England in 1945 two more such institutions came into existence at the time of termination of hostilities One of them was the Industrial Development Bank of Canada formed in 1944 and the other was the Industrial Finance Department of the Commonwealth Bank of Australia formed in 1946

This tendency to set up specialized institutions of industrial finance gained momentum in the post war years all the more since peace and reconstruction created enormous needs for capital Restoration of war damage re equipment of industries overworked or shut down during the war and the need for production to keep pace with the demand for goods and services spurred the demands for industrial capital to levels beyond the capacity of the existing institutional arrangements Further great expansion in the public domain linking with the concept of the welfare state housing construction on a very large scale and heavy capital outlay by nationalized industries and public services is a feature common to many countries Almost every country in the world today has specialized institutions for this purpose Not only on national basis but even on international scale a number of financial institutions have come into existence to help the industrial development on a

wider basis beyond the national boundaries, viz, the International Bank for Reconstruction and Development and its affiliates, the International Finance Corporation, the International Development Association, etc

Industrial Finance Corporation of India (I.F.C.)

The question of establishing a special institution for solving the problem of industrial finance in India had been before the country for a long time The necessity of setting up such an institution was stressed by the Indian Industrial Commission (1918), the External Capital Committee (1925) and the Central Banking Enquiry Committee (1930) But no action except a half-hearted attempt in one or two provinces was taken on their recommendations Towards the end of the second World War, however, attention once again came to be focussed on the problem of industrial finance The Developments in western countries and the establishment of special institutions served as an object lesson for India The two British institutions set up in 1945 attracted the greatest measure of attention A virtual absence of a well developed capital market and the dearth of issue houses and underwriting firms intensified effort in this direction Reconversion of war-time industry to a peace-time basis, re-equipment of war shattered industrial plant and machinery, rationalization and expansion of existing units and establishment of new industrial enterprises under the planned economy further served to motivate the idea

The Government of India made it clear in their statement on Industrial Policy issued in April 1945 with reference to their plans for the future industrial development of the country that the question of promoting an Industrial Investment Corporation or some such institution was under careful examination The decision was subsequently reached in the General Purposes Committee appointed by the Planning and Development Department that the subject should be examined by the Finance Ministry in consultation with the Reserve Bank of India In implementing the decision the Reserve Bank of India framed a Bill for establishing an Industrial Finance Corporation The Act establishing the Industrial Finance Corporation came into force from July 1, 1948

The object of the Corporation is to make medium and long-term credits[1] more readily available to industrial concerns in India, particularly in circumstances where normal banking accommodation is inappropriate or recourse to capital issue method is impracticable An 'industrial concern' has been defined to mean any public limited company or co-operative society incorporated by an Act of the Legislature and registered in India and engaged in the manufacture or processing of goods or in shipping or in mining or in hotel

[1] The terms 'medium' and 'long-term' have not been defined in the Act forming the Corporation

industry or in the generation or distribution of electricity or any other form of power

The scope of activities of the Corporation is confined to meet the financial needs of private large scale industry of the country It is not intended to meet the financial requirements of basic and nationalized industries nor of the small scale industries which are covered by State Financial Corporations As regards private industry the Corporation assists only the public limited companies and co operative societies and excludes from its purview the private limited companies and the partnership firms Neither the Canadian Industrial Development Bank nor the British Industrial and Commercial Finance Corporation has excluded partnership or private limited companies and it has been urged that the Corporation should provide finance to these concerns as well

The authorized capital of the Corporation is ten crores of rupees divided into 20 000 shares of Rs 5 000 each The paid up capital of the Corporation is Rs 8 35 crores contributed jointly by the Industrial Development Bank of India (50%) co-operative banks (8%) scheduled banks (20%) and the insurance concerns and investment trusts (22%) The shares are transferable only between the above categories of shareholders and no one else can hold them Further no institution can hold more than 10% of the shares reserved for the class of institutions to which it belongs The shares of the Corporation are guaranteed by the Central Government as to the repayment of the principal and the payment of annual dividend of $2\frac{1}{2}$%–4% The maximum rate of dividend is 5% The dividend at the maximum rate can be declared only when a reserve fund equal to the paid up capital has been created and the sums paid by the Government under guarantee have been repaid by the Corporation In any financial year after the reserve fund equals the share capital of the Corporation if any surplus is left after declaring a dividend at the maximum rate such surplus is to be paid to the Central Government The shares of the Corporation are deemed to be trustee and approved securities for purposes of investment The Central Government has reserved to itself powers to acquire at any time the shares held by shareholders other than the Industrial Development Bank by paying an amount equal to the paid up value of the shares together with a premium calculated at the rate of one per cent of the paid up value for every year from the date of issue to the date of acquisition subject to a maximum of 10%

The main eligible sources of funds of the Corporation are (i) own capital (ii) retained earnings (iii) repayment of loans and sale of investments (iv) borrowing from the market by issue of bonds (v) loans from Central Government and the Industrial Development Bank (vi) foreign credits and (vii) refinance from I D B I

The total resources of the Corporation as on 30th June 1966 and actual disbursements stood at Rs 159 crores as shown below

Sources of finance

(Rupees in crores)

	Funds	*Rs*		*Disbursements*	*Rs*
1.	Paid-up capital	8 35	1	Rupee loans	127 36
2	Reserves	6 45	2	Foreign Currency loans	16 31
3	Borrowings from market by issue of Bonds	33 48	3	Underwritings	13 52
4	Borrowings from the Central Govt	52 61	4	Direct subscription	1 82
5	Foreign Credits	14 41			
6	Repayment of loans etc	43 71			
	Total	159 01		Total	159 01

It will thus be seen that disbursements have been financed from the internal resources (including share capital) to the extent of about 37% and from borrowing from the market to the extent of 21% , the balance of about 42% coming from Government and foreign loans The General Reserve Fund stood at Rs 4 26 crores and Special Reserve Funds at Rs 2 19 crores on 30th June, 1966

The types of financial assistance which the Corporation is authorized to render are (i) long-term loans, both rupee and foreign currency , (ii) underwriting of equity, preference and debenture issues , (iii) subscribing to equity, preference and debenture capital , (iv) guaranteeing of deferred payments in respect of machinery imported from abroad or purchased in India , and (v) guaranteeing of loans raised in foreign currency from foreign financial institutions as also those raised in rupees from scheduled banks or state Co-operative Banks or floated in the public market The finances of the I F C are available for the setting up of new industrial projects as also for the renovation, modernization, expansion or diversification of existing ones

Financial assistance is given for a maximum period of 25 years and is secured by a pledge, mortgage or hypothecation of tangible assets The maximum amount of assistance the Corporation can grant to a single concern is Rs 2 crores The limit can be exceeded with the approval of I D B I The lower limit is not laid down, but in practice it is Rs 10 lakhs

The Corporation may impose such conditions as it may think necessary for protecting its interests, including the appointment of a director on the Board of the concern granted accommodation, or to take over the management of the concern which makes any default in repayment and to appoint directors of such concerns It can proceed against its defaulting debtors and can also call for repayment before the due date

The general superintendence and direction of the affairs and business of the Corporation is in the hands of a Board of Directors composed of 13 members as follows

(a) a chairman (wholetime) appointed by the Central Government after consulting the I D B I ,

(b) two Directors nominated by the Central Government ,

(c) four Directors nominated by the I D B I

(d) two Directors elected by the shareholder scheduled banks ,

(e) two Directors elected by the shareholder co-operative banks

(f) two Directors elected to represent Insurance Concerns, Investment Trusts and other Financial Institutions

The chairman of the Board holds office for 3 years, while the term of office of an elected director is 4 years that of a nominated director is at the pleasure of the authority appointing him. The Board is empowered to exercise all powers and to do all acts and things which may be exercised or done by the Corporation. In discharging its functions the Board acts on business principles due regard being paid to the interests of industry commerce and the general public. The Board is guided by such instructions on questions of policy as may be given to it by the I D B I If the Board fails to carry out the instructions on the question of policy laid down by the I D B I , the I D B I has the power to supersede the Board and appoint a new Board in its place

The Board is assisted by a Central Committee consisting of :

(a) a Chairman

(b) two Directors elected by the nominated Directors , and

(c) two Directors elected by the elected Directors.

The Chairman of the Board acts as the Chairman of the Central Committee

Subject to such general and special directions as the Board may from time to time give, the Central Committee is competent to deal with any matter within the competence of the Board. The minutes of every meeting of the Committee are laid before the Board at its next following meeting.

The Corporation may appoint one or more Advisory Committees for the purpose of assisting the Corporation in the efficient performance of its functions At present it has five such committees. The Corporation may appoint a General Manager and such other officers, employees and advisors as it considers necessary

The Head Office of the Corporation is in New Delhi. It has also established its offices in Bombay, Calcutta, and Madras. It has power to establish other offices or agencies in other places in India with the previous sanction of the I B D I

An application for loan received by the Corporation passes through several stages The application must contain details about the nature of the products manufactured, location of the factory, title to land and buildings, availability of power and technical staff, market prospects, costs of production, quality of machinery, value of security offered, purpose of the loan, and the capacity to earn profits

and to repay the loan, etc The application is first scrutinized at the head office which also obtains an inspection report of the factory from its branch manager in whose jurisdiction the factory is located The head office also obtains from the applicant concerned such further particulars or clarifications as it may find necessary The concern may send its own experts to discuss its claim with the Corporation's advisors The Corporation has five Advisory Committees, to deal with applications from textiles, sugar, engineering, chemicals and miscellaneous industries (electricals, paper, cement, glass, aluminium, non-ferrous metals, etc) The Corporation also seeks advice in case of need of different Ministries of the Government of India, particularly Commerce and Industry Food and Agriculture, and of the Council of Scientific and Industrial Research On the basis of the branch manager's inspection report and the data supplied by the applicant, the head office prepares a memorandum which is placed before the Advisory Committee concerned The recommendations of the Advisory Committee are placed before the Central Committee of the Board of Directors of the Corporation which may sanction the loan or reject it or may ask for modifications in the scheme Every application for loan is examined on its own merits by the Central Committee

The Corporation appraises industrial projects for financial assistance as business risks, and satisfies itself about their technical, financial and economic soundness The Corporation judges each project in the light of the several considerations involved, e g , (i) the industrial priority of the project relative to the economy of the country, (ii) the sources and availability of raw materials whether imported or indigenous (iii) the technical financial and economic viability of the project, (iv) the marketing prospects of the products to be manufactured, (v) the profit earning capacity of the project, (vi) the experience and probity of the promoters and their financial contribution, (vii) the quality of management, and (viii) the adequacy and competence of the technical and administrative staff during the construction and operation of the project With regard to the industrial priority of the project [item (i)], the Corporation must satisfy itself before granting financial assistance that the purpose for which it is proposed to be utilized is one which has the approval of the Central Govt , particularly with reference to the Five Year Plans For this purpose, any industrial concern for which a licence has been issued under the Industries (Development and Regulation) Act, 1951, is deemed to be established for a purpose which has the approval of the Central Government

The Corporation must also satisfy itself that (ix) the capital structure of the loanee company is sound and that the fixed interest bearing shares or debentures are not disproportionately large and that the company has not invested a substantial part of its surplus funds in other industrial concerns

The disbursement of a loan is made usually in instalments over the construction period of the project for the purposes agreed upon

at the time of sanctioning the loan Loans are given for productive purposes only, e g, purchase of new machinery, construction of factory buildings and purchase of land for factory site The Corporation's finance is not ordinarily available for working capital While a project is under construction, the assisted concern is required to submit periodical reports and the technical and financial officers of the Corporation visit the project from time to time to verify the physical and financial progress Throughout the currency of the loan, the Corporation keeps close touch with the project through regular progress reports, audited balance sheets, periodical spot inspections by its officers and also by appointment of nominee directors, where necessary, on the boards of the assisted concerns *The Corporation does not seek or take active part in the management of the enterprises which it finances*

The Corporation was started at a time when Indian industries were in need of large long-term capital to establish new undertakings and to replace worn-out plants and when conditions in the capital market were deteriorating and it was becoming increasingly difficult even for good concerns to raise capital from the market[1] Though the progress of the Corporation during the initial period of five years was slow and halting,[2] the financial assistance rendered by the Corporation has enabled many industrial units not only to survive but also to expand and achieve a more economic size It has also helped new units during the period of confinement During the first decade of its existence, it advanced loans to about 200 concerns, and today the Corporation has become the most important industrial mortgage lending institution not only in India but in the whole of Asia

Financial assistance sanctioned (1949-66)

(Rupees in crores)

Period or year ended 30th June	*Net assistance sanctioned*				*Amount disbursed*		
	Loans	*Guarantees for deferred payments*	*Underwritings*	*Total*	*Loans*	*Others*	*Total*
1949 51	8 13	—	—	8 13	5 79	—	5 79
1st Plan	27 02	—	—	27 02	10 94	—	10 94
2nd Plan	50 38	14 54	3 56	68 48	40 62	11 32	51 94
3rd Plan	132 63	37 45	19·04	189 12	86 32	46 54	132 86
Total	218 16	51 99	22 60	292 75	143 67	57 86	201 53

During the 18 years (1949-66) the Corporation sanctioned financial assistance amounting to Rs 293 crores to 430 industrial units

1 According to a study by the Reserve Bank actual capital issues (including shares and debentures) were 1948 Rs 21 9 crores, 1949 Rs 16 3 crores, 1950 Rs 14 6 crores, 1951 Rs 9 3 crores and 1952 Rs 4·7 crores The sharp decline is obvious

2 The amount of loans sanctioned per year averaged Rs 2 4 crores during first five years (1949-53) and increased to an average of Rs 7 7 crores in the next five years and to an average of Rs 15 5 crores in the next five years (1959-63)

comprising 642 loans and 211 underwriting operations The total amount actually disbursed during the same period was Rs 201 53 crores The Corporation s financial assistance has been on an increasing scale from year to year The annual average of financial assistance prior to the First Five Year Plan was Rs 2 71 crores, during the First Plan period Rs 5 40 crores, during the Second Plan Rs 13 69 crores and during the Third Plan Rs 37 82 crores These figures show a very good jump during each five year plan

While the figures of total assistance rendered by the Corporation *are impressive enough, they do not tell the whole tale* Even more noteworthy is the total cost of the projects which have come to *fruition because of the I F C assistance estimated at* Rs *975 crores*, i e , roughly 30% of the total net investment in the organized industries *in the private sector since independence*

Out of Rs 292 75 crores sanctioned till June 1966, Rs 196 30 crores (67 0%) was for setting up of new units, Rs 80 90 crores (27 6%) for expansion, Rs 6 95 crores (2 4%) for diversification of production, Rs 6 37 crores (2 2%) for modernization and rehabilitation, and Rs 2 23 crores (0 8%) for working capital The relative importance of the financial assistance from the Corporation in relation to the total finance required by the borrowing concerns for setting up new units and expansion, rehabilitation modernization, etc , of existing ones may be gauged from the following figures

(Rupees in crores)

	Nature of the Scheme	*Total cost of the scheme*	*Financial assistance approved*	%	*% to total cost*
1	Setting up of new units	611 91	196 30	67 0	32
2	Expansion of existing units	337 84	80 90	27 6	24
3	Modernization and rehabilitation	11 08	6 37	2 2	58
4	Diversification of Production	14 33	6 95	2 4	49
	Total	975 16	290 52	99 2	30
5	Loans for working capital	—	2 23	0 8	—
			292 75	100	

Since December 1957, when the Corporation was authorized to guarantee deferred payments in respect of capital goods imported from abroad the Corporation approved 53 applications valued at Rs *51 crores till 30th June 1966* The value of guarantees actually issued by the Corporation amounted to Rs 28 66 crores

The Corporation has since December 1956 underwritten stocks, shares, *bonds or debentures of industrial concerns to the extent of* Rs 20 78 crores up to June 1966 The proposals related to a wide range of *industries, viz , cement,* glass and glass products, pottery,

Co-operative societies have received special attention of the Corporation, but only the sugar, cotton textile and vegetable oil industries have taken advantage of this favour

Since the Pakistani attack in August 1965, the Corporation has decided to give special consideration to loan applications from defence oriented industries and also from under developed areas

Thus, the Corporation has made itself more and more useful to the industry as it has gained strength and acquired experience during these years It has enabled a number of new enterprises to establish themselves firmly and pay attractive dividends It has also financed expansion modernization and renovation of existing units

Since the formation of the Industrial Development Bank in April 1964, the Corporation functions as the subsidiary of the Industrial Bank and in course of time may be fully merged with it

State Finance Corporations (SFCs)

Among the important measures taken by the Government to develop an adequate institutional framework for the provision of long-term finance to Indian industry in the private sector as part of promotion of rapid economic growth is the establishment of State Finance Corporations Such Corporations are functioning nearly in all the states at the present time

At the time of the enactment of the Industrial Finance Corporation Act in 1948, it was recognized that the All-India Corporation would not be able to cater to the needs of all type of industries and that its sphere of activities would have to be necessarily restricted to large scale industries Financial assistance to be granted by it was, therefore, deliberately limited to public limited companies or co-operative societies the small scale and medium sized industries were excluded from its purview Moreover the small and medium sized industries being scattered over the whole country, it was not possible for a central organization to render appropriate aid to all of them The I F C also could not give any loan of less than Rs 10 lakhs It was, therefore made clear that it would be necessary to set up State Finance Corporations for financing small and medium scale industries to supplement the work of the I F C of India Further, it was considered desirable that, in the case of the proposed S F Cs, industrial concerns eligible for assistance should include private limited companies, and other private enterprises, besides public limited companies and co-operative societies Accordingly the State Finance Corporations Act was passed by Parliament on September 28, 1951, as an enabling measure, under which S F Cs could be established Provision was also made to bring within the scope of the Act any institution already in existence and concerned with the financing of industries This was done at the instance of the Madras Government, which desired to bring within the scope of this Act the Madras Industrial Investment Corporation Limited, which had been incorporated under the Indian Companies Act in March, 1949

The provisions of the State Finance Corporations Act are, broadly, similar to those of the I F C Act Like the I F C, they are also publicly owned by the State Governments The types of assistance which the S F Cs are authorized to render are the same as those extended by the I F C Such assistance, however, is restricted to a maximum period of 20 years Loans to a single concern may be made with a maximum of Rs 10 lakhs, the minimum limit in practice being Rs 10 000 [1]

The first corporation set up under the Act was the Punjab Finance Corporation which was established in Feb 1953 There were six corporations at the end of 1953-54 ten corporations at the end of 1954-55 and as many as thirteen corporations functioning by the end of 1955-56 the accelerated tempo of economic activity towards the end of the First Five Year Plan speeding up their formation in the later years Consequent upon the changes resulting from the reorganization of states the number declined by two through amalgamation by the end of 1956 With the formation of corporations in Mysore and Jammu-Kashmir in 1959, and the separation of Gujarat as a separate state with a separate corporation formed in 1960, the number of corporations now has gone up to 15, each major state having one corporation The Union Territories of Delhi and Himachal Pradesh are served by the Punjab S F C., those of Tripura and Manipur by Assam S F C and of Goa, Daman and Diu by the Maharashtra S F C Proposals are also under consideration to extend the jurisdiction of West Bengal and Gujarat S F Cs. to serve the needs of industries in the Union Territories of Andaman and Nicobar Islands and Dadra and Nagar Haveli respectively The aggregate authorized capital of these corporations is Rs 34 50 crores, of which Rs 16 35 crores is paid up as shown in the adjoining table

The State Finance Corporations Act enables each State Government to fix the authorized capital of its corporation, subject to a minimum of Rs 50 lakhs and a maximum of Rs 5 crores. The actual authorized capital of the existing corporations ranges between Rs 2 crores and Rs 4 crores, as many as ten out of the fifteen having an authorized capital of Rs 2 crores each. Two corporations (Andhra Pradesh and Maharashtra) have an authorized capital of Rs 4 crores each, two (Uttar Pradesh and Madras) of Rs. 3 crores and one (Jammu and Kashmir) of Rs. 50 lakhs only As regards paid-up capital the Madras Corporation has the largest amount at Rs 2 35 crores, while at the other end stands Jammu and Kashmir Corporation with Rs 50 lakhs. The rest of the corporations have a paid up capital of Rs 1 crore each, except the Andhra Pradesh Corporation with Rs 1 50 crores

While only the Industrial Development Bank and financial institutions can participate in the share capital of the Industrial Finance Corporation of India, the general public can also subscribe to the share capital of the S F Corporations, though subject to a

1 Lending powers have been raised from Rs 10 lakhs to Rs. 20 lakhs in the case of public limited companies and co-operative societies since 1962.

Operations of State Finance Corporations (on 31st March, 1966)

(Lakhs of Rupees)

Name of Corporation	Date of Formation	Autho-rized Capital	Paid-up Capital	Bonds Out-standing on 31-3 66	Loans Sanctioned during 1965 66	Loans Disbursed during 1965-66	Loans Out-standing on 31 3 66
1	2	3	4	5	6	7	8
1. S F C , Madras	26-3-49	300	235	236	455	289	1003
2 S F C , Punjab[1]	1-2-53	200	100	400	241	163	630
3 S F C , Kerala	23-11-53	200	100	109	128	45	197
4 S F C , W Bengal	1-3-54	200	100	404	197	115	576
5 S F C , Assam	19-4 54	200	100	282	46	34	367
6 S F C , U P	25-8-54	300	100	145	75	82	267
7. S F C , Bihar	2-11-54	200	100	150	31	24	250
8 S F C , Rajasthan	17-1-55	200	100	125	123	62	257
9. S F C , M P	30-6 55	200	100	199	197	141	339
10 S F C , Orissa	20-3-56	200	100	100	32	47	188
11 S F C., Maharashtra	1-11-56	400	100	578	236	246	916
12. S F C , Andhra	1-11-56	400	150	205	221	155	424
13 S F C , Mysore	30-3 59	200	100	191	145	79	282
14 S F C , Jammu-Kashmir	2-12-59	50	50	—	40	24	44
15 S F C Gujarat	1-5 60	200	100	156	158	101	259
Total		3450	1635	3280	2325	1607	5994

[1] The Punjab State Finance Corporation has set up a Sub-office in Delhi and thus extended its activities to that State also An Agreement was signed in May 1962 by the Govts. of Punjab, Delhi and Himachal Pradesh to have a joint Corporation Thus, the activities of Punjab Corporation have now been extended to Himachal Pradesh also where a Sub-office also has been set up at Simla Manipur was included in the area of operation of Assam Corporation in 1963

maximum of 25% of the total The share of the State Governments ranges from 60% to 30%, that of the Reserve Bank from 21% to 13% and that of the financial institutions from 50 to 17% The contribution by the general public in no case exceeds 10% of the total, although, the maximum statutory limit is 25%

The share capital of each corporation is guaranteed by the State Government concerned as regards the repayment of principal and the payment of an annual dividend at the minimum rate of 3½%[1] It is fixed by the State Government in consultation with the Central Government The maximum rate of dividend payable by a corporation is limited to 5 by the Act and any surplus in the net profits after repayment of dividend at this rate accrues to the State Government

Besides the share capital the resources of the corporations comprise reserves bonds and debentures short term borrowings from Government the Reserve Bank I D B I and fixed deposits from the public With the growth in the volume of their lendings and the consequent stretching of their resources the corporations have issued bonds and debentures to augment their resources The total amount of bonds and debentures issued by the corporations and outstanding at the end of March 1966 was Rs 32 80 crores Only the Kerala, Maharashtra, Assam, Andhra Pradesh, Gujarat and Rajasthan Finance Corporations and the Madras Industrial Investment Corporation have accepted deposits so far Most of the corporations have also availed of the facility of the borrowing from the Reserve Bank of India against government securities

The management of each corporation is entrusted to a Board of ten directors The State Government concerned appoints the managing director generally in consultation with the Reserve Bank and nominates three other directors The Reserve Bank and the I F C of India nominate one director each The scheduled banks, insurance companies, investment trusts co-operative banks and other financial institutions elect three directors, one of whom represents the scheduled banks, another the co-operative banks and the third represents the remaining financial institutions The other share holders are represented by one director elected from among them selves The majority of the directors are thus nominated by the Government and quasi government institutions The Board is guided by instructions on matters of policy given by the State Government in consultation with the Reserve Bank The Board acts on business principles and is assisted by an Executive Committee of four directors including the Managing Director who acts as the Chairman of the Committee The corporations may also have one or more Advisory Committees in order to discharge their functions efficiently and to meet the requirements of particular areas or industries.

The types of assistance which the corporations may render,

1 The minimum rate of guaranteed dividend is only 3% in the case of the Punjab and Madras Corporations

are similar to those of I F C of India Thus, the State Finance Corporations may (a) grant loans or advances to, or subscribe to shares and debentures of industrial concerns repayable within a period of 20 years, (b) *guarantee loans raised in the market* by industrial concerns and repayable within 20 years, underwrite the issue of stocks, shares, bonds or debentures by industrial concerns, subject to the condition that any part of the issue taken up in pursuance of the underwriting agreement is disposed of within seven years *The corporations are prohibited from subscribing directly* to the shares or stocks of any company, because *their object is* to assist industrial concerns in obtaining capital and to act as holding companies or investment trusts

The financial assistance rendered by the corporations so far has been through the grant of loans and advances and the investment in shares and debentures Their subscription to debentures has been *insignificant Only six corporations have subscribed* to shares of industrial concerns and only three to the debentures of industrial concerns One of the corporations has underwritten shares and another has guaranteed deferred payments but undertaking of such types of business is engaging the attention of others

There has been an increase in loans and advances sanctioned from less than Rs 1 crore by two corporations in 1953-54 to Rs 5 *crores by 12 corporations in 1958-59 and Rs 9 16 crores by* 15 corporations by 1960-61 The loans sanctioned during the years 1961-62 and 1962-63 were Rs 12 91 and Rs 18 33 crores During the 10 years period, 1953-54 to 1962-63 as a whole, the amount of loans sanctioned aggregated Rs 67 38 crores, of which Rs 41 57 *crores, or over 60% were disbursed Loans sanctioned, disbursed* and outstanding at the end of the year 1965-66 were Rs 23 25 crores, Rs 16 07 crores and Rs 59 94 crores, respectively

The recipients of financial assistance cover a wide range of industries Absence of a uniform industrial classification in the data makes it difficult to give a detailed industrywise break-down *of the aggregate loans and advances of all corporations taken* together It is however, clear that of the total loans sanctioned by all the corporations, textile and engineering industries received the largest share followed by sugar, tea, chemicals, basic metal industries and paper In the case of the Maharashtra and the Punjab corpora*tions a good part of the loans* sanctioned was *for engineering and* textile industries, in Maharashtra each of these industries accounted for about a quarter of the total loans sanctioned, while, in the Punjab, textile manufacturing and processing and engineering concerns accounted for 29% and 13%, *respectively, of total loan assist*ance Textiles were also responsible for nearly 70% and 56%, respectively, of the total loans sanctioned in Madhya Pradesh and Madras In Bihar, cold storage and engineering industries were prominent receiving 35% and 23%, respectively, of the total loans Tea, *rubber and textile concerns accounted for 57% of the total loans* in Kerala, oil mills and textiles for 48% of the total in Andhra

Pradesh, and engineering, cotton textiles and jute for 46% in West Bengal. In Assam, 57% of the total loans went to electric supply and tea industries, in U.P. 42% to sugar and ice and cold storage and in Rajasthan 72% to textiles, sugar and mining industries.

Loans given by the corporations are sufficiently secured, being granted on the first mortgage of the fixed assets in the form of land, buildings and plant and equipment. The amount of the loan is usually about 50% of the net value of the assets offered as security, thus providing a margin of 50%. The corporations are also empowered to grant guaranteed loans. Financial assistance has been rendered primarily for block capital and only in exceptional cases for working capital. The period of loans granted generally is for 10 to 12 years. Loans are granted by the corporations on the merits of individual concerns after due scrutiny of the proposals with the aid of technical advice. The corporations also keep a watch over the progress of the concerns assisted through regular inspections by their officials in addition to obtaining periodical reports from them.

In view of the significantly lower rates of interests charged by State Governments in respect of their loans to small scale industries under the concessional scheme of finance and in order to avoid possible adverse repercussions this might have on the operations of the corporations, the State Finance Corporations Act was amended in October 1956, empowering the corporations to act as agents for the Central or State Governments or the Industrial Finance Corporations of India in respect of loans and advances granted or debentures subscribed to by them. Such agency arrangements are in operation now in 12 states. Besides, provision has been made in the amended Act, *inter alia*, (i) for inspection of the working of the corporations by the Reserve Bank, (ii) submission by the Corporations of their yearly balance sheets and profits and loss accounts to their respective State Governments and the Reserve Bank, and (iii) granting of financial accommodation to industries against the guarantee of a State Government, a scheduled bank or a state co-operative bank. As a result of the amendments the corporations have been placed on a firmer footing and the scope of their activities has been widened. Further, the day-to-day problems of the corporations are solved by holding annual conferences of their representatives by the Reserve Bank of India to facilitate discussions and mutual exchange of ideas. A summary of some of the proposals adopted at the Seventh Conference held in December 1960 is given below.

(1) The corporations were urged to grant loans jointly with the State Bank of India or I.C.I.C. or I.F.C.

(2) In regard to routing of Govt. concessional finance, it was agreed that all loans within a specified range should be routed through the corporations and there should be no duplication between the corporations and the State Government in this regard. The conference also urged that appointment of corporations as agents in other states should be expedited.

(3) Some of the important suggestions approved for expanding or facilitating the operations of the corporations by amending the S F C Act were as follows

(a) Provisions for enabling the corporations to borrow funds from the Refinance Corporation (now merged with I D B I) and such other financial institutions as may be notified by the Central Government

(b) Provision for enabling the corporations to retain shares etc, taken up by them in fulfilment of underwriting liabilities beyond a period of 7 years with the approval of the State Government

(c) Provision for enabling the corporations to act as agents of any financial institution approved by the State Government

(4) The conference adopted the following proposals for the liberalization of the terms and conditions governing loans sanctioned

(i) *Personal guarantees*—The corporations might not insist upon personal guarantees in the case of loans granted to well-established concerns with good management and past performance

(ii) *Period of repayment of loans*—In the case of small-scale and newly established industries, the schedule of repayments might be modified in such manner that the burden of repayment, especially in the initial stages, was not too heavy

(iii) *Margin*—The suggestion of the small-scale industries board to sanction loans up to 75% of the value of security offered was reviewed and it was decided to modify the rigid margin requirements and relax them in suitable cases to the extent considered appropriate by the corporations

The most vital decision taken at the eighth conference of the corporations held in December 1961 was the clarifications offered by the Reserve Bank that there was no ban on the participation by the S F *Corporations in the equity capital of the companies* The Corporations can now divert their resources to this channel and hope to earn substantially more, provided the underwriting or share participation is done after careful assessment of the projects

Though the growth of the activities of the corporations has been slow and halting because of the irksome adherence to their red tape, yet they are rendering a valuable service to small and medium-scale industries The ratio of loans to total assets stands at a high figure of 75%, Three of the Corporations have been able to meet *its entire dividend liability from its own profits* Maharashtra Corporation sanctioned a loan to a textile mill which had remained closed for 6 months due to financial difficulties

A depressing feature of the working of many of these corporations has been their inability to meet their commitments of guaranteed *dividends* As many as 12 corporations needed subvention

from their states for honouring this oblication. The corporations have been criticized for their persisting incapacity to expedite procedure for screening of loan applications and lack of innovation in expanding their business. Reasonable complaints are mounting up in regard to the time consuming formalities of screening of loan applications. The corporations should strengthen the technical staff at their disposal in order to ensure expeditious and efficient handling of the applications. The procedure for granting loans also needs to be clarified to the applicants so that the interval between the receipt of an application and the actual date of sanction may be reduced to the minimum. Some of the entrepreneurs have been scared away from these corporations because their reliance on them tended to prolong the completion of their projects and indirectly enhanced the initial cost. Some of the corporations, notably those of Andhra Pradesh, Madhya Pradesh and Mysore have idle resources with them and they will have to take appropriate steps to use their loanable funds more intensively even by going out of their way to meet the financial needs of industries. On the contrary, the total assets of all the 15 corporations are hardly 60% of those of the Industrial Finance Corporation of India which is a sharp reminder that the corporations at the state level have to accelerate the rate of their operations if they are to meet the challenge of expansion in the economy.

The elementary problem of lack of resources, prohibitive statutory provisions and unhealthy practices still persist and the scale of operations continues to be too small to allow scope for a reduction in expenses ratio and increase in productivity. The corporations with their meagre resources and reserves cannot undertake the larger risks and greater responsibilities of underwriting and guarantee business in substantial proportions. The Working Group on the S F Cs in its report, submitted in 1964 suggested several changes in their current practices and existing legal provisions as well as in the attitude of the corporations. The Group also suggested that the State Governments might guarantee the deposits of S F Cs in the same way as they guarantee their bonds.

There is an imperative need for the corporations to function in a businesslike manner by utilizing the funds gainfully and by avoiding wastage of resources. It would also be worthwhile examining whether there is need for one corporation for each state and whether it would be more advantageous to merge them into fewer corporations on a regional basis.

National Industrial Development Corporation (N I D C)

The National Industrial Development Corporation was sponsored by the Government of India in October 1954. It was registered as a private company under the Indian Companies Act with an authorized capital of Rs 1 crore and subscribed capital of Rs 10 lakhs. The finances of the Corporation are provided by the Government in the form of grants and loans. A sum of Rs 55 crores was allotted to it for its activities during the Second Five Year Plan

period During the period of the Third Plan grants were made against specific projects (Rs 3 crores for Drugs project) The Corporation is also empowered to increase its financial resources by issuing shares or debentures and by receiving grants, loans, advances or deposits from the Central or State Governments, banks, companies or individuals

The Corporation is an important instrument for securing the harmonious development of industries in both the public and private sectors The primary object of the corporation is to enable the Government to promote the development of new basic and heavy industries particularly those which are necessary to fill up the gaps in the industrial structure It undertakes financing of industries only in so far as it is incidental to such development It gives priority to the establishment of the manufacture of capital goods, machinery and equipments for other industries It takes up the study and investigation of industrial schemes, and, in implementing them, tries to secure, where possible, the maximum use of industrial equipment, experience and skill available in the private sector In other cases, it may itself set up industries, which might in their turn lead to the growth of ancillary industries in private sector

The primary function of the Corporation is to promote, establish and operate schemes likely to advance the industrial development of the country For this purpose, it can render assistance to any type of industrial undertaking, whether it is owned or managed by the Government, statutory body company, firm or individual The assistance can be provided in the shape of capital, credit, machinery, equipment or any other type of facility The Corporation can provide finance to industrial undertakings in different forms Thus it can grant loans and advances to industries It can subscribe to, underwrite or deal in the shares and debentures of companies It can also guarantee loans and advances to industries, as well as issues of shares and debentures made by companies Its own capital can be invested directly in companies formed for running an industrial undertaking approved by it Certain powers have been granted to the Corporation in order to enable it to exercise control over industrial undertakings with which it is connected Thus, it can manage control or supervise a concern by nominating directors or advisors or otherwise collaborating with it It can enter into partnership or any other arrangement for joint working with a concern It can also promote, establish or assist any concern formed with a view to setting up or running an industrial undertaking

The Corporation can have a minimum of 15 directors and a maximum of 25 directors The Board of Directors at present is composed of 15 members including the Chairman (who is the Minister incharge of the Ministry of Industry) the Vice-Chairman and the Managing Director *The Board includes both officials and non-officials and is nominated by the Central Government By the inclusion of industrialists, scientists, and other experts on the Board of Directors, the Corporation is able to integrate the*

development of public enterprises established by it with development elsewhere and thus help in securing a synthesis of public and private sectors

Industrial projects Since its inception the Corporation has examined a number of industrial projects which had been selected, with the approval of the Central Government, for technical and economic study The projects were chosen primarily with a view to develop new lines of production in fields where the country was exclusively or mainly dependent upon imports.

Where the execution of a project is to be undertaken by the N I D C the method adopted depends upon the circumstances of each case Although initially the capital may be wholly from Government sources it is not necessary that this should be the case in all instances or for all times The project might be executed by the Corporation itself or by a subsidiary company The project could also be executed in collaboration with private enterprise The nature and extent of foreign financial or technical collaboration and participation if any is also decided according to the circumstances

The Corporation has concentrated its efforts on projects relating to the manufacture of industrial machinery in the field of heavy engineering including the establishment of Foundry and Forge capacity for such manufacture of and production of some crucial industrial raw materials like raw film, aluminium, synthetic rubber, basic organic chemicals and intermediates, sulphur, phosphorus, etc. Preliminary studies and investigations have been completed in regard to a number of these projects and their implementation has been entrusted to the Government Corporations. The Heavy Machine Building Plant and the Coal Mining Machinery Plant and the Heavy Foundry Forge Projects have been entrusted to the Heavy Engineering Corporation set up at Ranchi for this purpose. Projects relating to the manufacture of sulphur from pyrites, raw film for the cinema industry and the organic chemicals and intermediates have been entrusted to separate corporations Some of the schemes for the manufacture of industrial raw materials, viz., synthetic rubber, carbon black, tungsten carbide, rayon grade pulp etc., for which necessary preliminary studies were carried out by the Corporation, have been assigned to the private sector to follow up and establish production units

The chief agency through which the Corporation works is the Technological Consultancy Bureau set up in 1960 The Bureau is at present engaged in the development of the following projects:

1 Alumina Project, Korba (M P.)
2. Ball and Roller Bearing Project.
3 Pumps and Compressors Project.
4 Bio Gas Project.
5 Pulp Paper-Newsprint Plants in Public Sector.
6 Instrumentation Ltd., Kota and Palghat.

7 Machine Tool Projects (Ajmer and Bhavnagar)
8 Central Workshop for Kolar Gold Mines
9 Demand Survey for Automobile Ancillaries
10 Manufacture of Seamless Pipes, Cranes, Hoists and Structurals
11 Development of Industries in Tripura
12 Alkaloids Project Madhya Pradesh
13 New Industries in Andhra Pradesh and Uttar Pradesh
14 Design of Township for Messrs Hindustan Organic Chemicals Ltd and Fertilizer Corporation of India, Gorakhpur
15 Locational studies for location of Future Aluminium Plants
16 Marine Diesel Engine Project
17 Pig Iron Plant M P
18 Andhra Pradesh Industrial Development Corporation
19 Demand Surveys for textile machinery
20 Indian Drugs and Pharmaceuticals Ltd

The Pyrites and Chemicals Development Company Ltd, which was set up as a subsidiary of the Corporation plans to mine 300 000 tonnes of pyrites ore per year from the Amjhore deposits The company also proposes to set up two pyrites based sulphuric acid units adjacent to large size nitrogenous fertilizer factories at Sindri and Durgapur The Company, however, has now been made independent of the Corporation directly under the control of the Government of India

Loans for rehabilitation of industries The Government uses the Corporation as an agency for the grant of loans to any industry which they may desire to assist Originally the scheme covered loans for the modernization and rehabilitation of *the jute industry* and *the cotton textile industry*, but now Government have decided to utilize the Corporation as an agency for advancing loans to the units manufacturing *machine* tools also

The Corporation invites applications from the units who require such assistance The Corporation has set three Advisory Committees in Calcutta, Bombay and New Delhi for the scrutiny of applications from jute mills cotton textile mills and machine tool units respectively These Committees include representatives of the industry concerned and of the Central Government, besides those of the Corporation

The Corporation has published in a memorandum the terms and conditions on which it grants loans to jute and cotton textile mills The loans are granted for a term not exceeding 15 years for purchase of machinery required for modernization and rehabilitation on the mortgage of fixed assets The mill company is also required to execute a sub-mortgage in favour of Government of India The loans advanced are repaid in 15 equal annual instal-

ments, the first instalment being payable within 18 months from the date the loan was drawn The rate of interest charged is $7\frac{1}{2}$%, but the Corporation may accept interest at 5% if instalments of principal and interest are paid on due dates Unless and until a provision has been made for the payment of instalments due, the company is forbidden from declaring any dividends or making any allocation to reserves out of profits of any year The Corporation has the right to nominate one of the directors on the Board of Directors of the company who is not liable to retire by rotation The Corporation has also the right to inspect the company's factory and books of account and to carry out a technical investigation of its affairs The company is required to submit to the Corporation such returns and reports as may be called for or to amend its Articles of Association with a view to conform to the terms and conditions of the loan The loans sanctioned by the Corporation to jute cotton and machine tools units amounted to Rs 28 2 crores till end of 1965-66, of which Rs 17 1 crores was actually drawn by the industries The Government discontinued the scheme of grant of loans through the Corporation to cotton textile and jute mills for modernization and rehabilitation in 1963 Instead the work of considering loan applications from jute and cotton textile mills has now been entrusted to the Industrial Development Bank constituted early in 1964 Accordingly the Ministry of Industry has advised the Indian Jute Mills Association and the Indian Cotton Mills Federation to contact the Industrial Development Bank regarding the procedure for grant of loans

The Corporation's short term (rental) scheme for the provision of indigenous machinery to jute and cotton textile industries on hire purchase system has also made good progress and assistance aggregating Rs 3 8 lakhs was sanctioned by March 1966

The Corporation set up Working Groups to study the problems of modernization of cotton textile, woollen and silk industries during 1959 The reports of the groups threw enough light on the problems and suggested ways and means for the modernization of these industries during the Third Five Year Plan

Industrial Development Bank of India (I.D B I.)

The Industrial Development Bank of India (I D B I) was established in July 1964 in terms of the Industrial Development Bank of India Act, which was passed by Parliament in May 1964 The Bank was set up as part of a reorganized and integrated structure of industrial financing institutions in the country, geared to the needs of rapid industrialization The main object was to bring into existence an apex institution to co ordinate the activities of other financial institutions, including banks, providing term-finance to industry as well as to provide direct financial assistance to industrial units to bridge the gap between the supply of and demand for medium and long term finance Although the assistance, provided by the specialized industrial financing institutions set up in the country since Independence has shown a steady increase, their likely contribution

in providing term-finance to industry was considered to be inadequate in relation to the substantial investment outlays envisaged in the Third and succeeding Five Year Plans, both in magnitude and range of financing In view of the dimensions of the problem that rapid industrialization poses, an apex institution with substantial financial resources and considerable operational flexibility was considered necessary

The role of the Bank has been conceived not merely as one of enlarging the usefulness of the existing financial institutions by supplementing their resources and widening the scope of their assistance for financing of industrial development and expansion The Bank would also be a central agency, which ultimately will be concerned, directly or indirectly, with all problems relating to the medium and long-term financing of industry, ensuring not only the flow of funds to enterprises and projects which are in accord with the Plan priorities but also, if necessary, adopting and enforcing a system of priorities for promoting future industrial growth The Bank is also designed to function as a developmental agency, with special responsibility to fill the gaps in the industrial structure and to develop certain vital and strategic sectors like fertilizers, alloy and special steels and petro-chemicals The Bank has thus emerged as a pivotal financial institution which has been assigned an important role in the tasks of planned development in industry

The Bank is a wholly-owned subsidiary of the Reserve Bank of India and the direction and management of its affairs are vested in a Board of Directors which is the same as the Central Board of Directors of the Reserve Bank The Board has constituted an Executive Committee to discharge some of its functions Several considerations have weighed with the Government in making the Bank a wholly-owned subsidiary of the Reserve Bank The I D B I is, in a sense, a lender of the last resort for all periods other than the short-term and its role is in some respects akin to that of the Reserve Bank Secondly, with the passage of time, the operations of the I D B I are likely to assume considerable dimensions and would need to be generally regulated within the framework of proper monetary management, a task which falls within the special sphere of responsibility of the Reserve Bank Thirdly, for some years now, the Reserve Bank has steadily expanded its role in the field of industrial finance It was, therefore, advantageous to have an institution legally separate from the Reserve Bank but closely associated with it to look after the corpus of activities relating to industrial finance

The authorized capital of the Bank is Rs 50 crores, which may, if necessary, be increased to Rs 100 crores Its issued capital to begin with is Rs 10 crores subscribed wholly by the Reserve Bank of India The share capital of the I F C held by the Government of India and the Reserve Bank has been transferred to the I D B I, and to acquire controlling interests in the I F C, it has purchased more of shares The finances of the Bank have been supplemented by an interest free loan of Rs 10 crores from the Central Government

repayable in 15 equal instalments after a period of 15 years from the date of loan. The Central Government may grant further loans. The bank is also entitled to borrow from the Reserve Bank for periods up to 90 days against trustee securities and up to 5 years against bonafide commercial bills or promissory notes bearing two good signatures For long terms, the Bank can borrow from the National Industrial Credit (long-term operations) Fund, which was established by the Reserve Bank with initial contribution of Rs. 10 crores and five annual contributions of Rs. 5 crores from the profits of the Reserve Bank commencing with the year ending on June 30, 1965 This is on the obvious analogy of a similar fund for agricultural credit created on the recommendations of the Rural Credit Survey Committee The Bank has at its disposal a fund, called the Development Fund, built up from contributions made by the Central Government from time to time to enable the Bank to provide assistance for projects which, for various reasons such as heavy investment involved or low anticipated rate of return on capital, may not be able to raise finance from banks or other lending institutions but which may nevertheless be considered as of importance justifying special assistance. The resources of the Fund will primarily comprise contributions from the Central Government by way of loans, gifts, grants, donations, etc. The Bank can further borrow, with the Central Government's approval, foreign currency from any foreign bank or financial institution and can also raise deposits or borrow money on bonds in India. The Bank thus has ample resources from the very commencement of its operations.

The Bank is managed by a Board of Directors, whose membership is the same as that of the Central Board of Directors of the Reserve Bank. The activities of the Bank are:

(i) *To finance all types of industrial concerns* engaged in the manufacture of or processing of goods, mining, transport, generation and distribution of power etc., both in the public and private sectors; for the present, however, the Bank has restricted itself to the financing of largely private sector enterprises. There are no restrictions as regards the nature and type of security accepted, nor any maximum or minimum limits prescribed for assistance to be provided.

(ii) The operations fall into two broad groups: (a) *assistance to other financial institutions,* and (b) *direct assistance to industrial concerns,* either on its own or in participation with other institutions.

(a) Assistance to other financial institutions covers such activities as refinancing of loans given by other institutions specified in the Act and those subsequently notified by the Central Govt. (I.C.I.C.I.) and subscribing to their shares and bonds as well as guaranteeing their underwriting obligations in connection with the shares and bonds issues of industrial concerns. The eligible institutions are Industrial Finance Corporation of India, State Finance Corporations, Industrial Credit and Investment Corporation of India,

Scheduled Banks and State Co operative Banks Loans to be eligible for refinance should be repayable between 3 and 25 years in the case of financial institutions and between 3 and 10 years in the case of Scheduled and State Co-operative Banks The Bank took over the business of Refinance Corporation of Industry on September 1, 1964, which was dissolved finally on July 26, 1965

(b) Direct financial assistance to industrial concerns is in the form of loans and advances, subscribing to, purchasing or under writing issues of stocks, shares, bonds or debentures, guaranteeing deferred payments due from industrial concerns to third parties and loans raised by them in the open market or from financial institutions The Bank may also accept, discount or rediscount commercial bills or promissory notes of industrial concerns In providing direct assistance the Bank attempts to secure the collaboration of other institutions and to fill the gaps that remain after taking into consideration the assistance available from other institutions

(iii) The Bank may undertake *promotional activities* such as marketing and investment research and surveys as well as techno-economic studies, besides *giving technical and administrative assistance* to industrial enterprises *for promotion, management and expansion*

It is planned as an institution which will co-ordinate the activities of all institutions engaged in the task of financing industrial development It is an aid to industrial growth and as an incentive to genuine entrepreneurs It will serve well the objective of promoting democratic socialism to which the country is pledged

Provision has been made for the Development Bank to make the I F C its subsidiary or to completely absorb the Corporation

The financial assistance provided by the bank in the first two years of its working is shown below

(Rupees in crores)

Type of assistance	*Assistance Sanctioned* *1964 65* (*July-June*)	*1965 66* (*July-June*)	*Assistance Disbursed* *1964-65* (*July-June*)	*1965 66* (*July-June*)
1. Refinance	25 1	23 0	21 2	22 3
2. Direct loans to industrial units	16 2	35 6	—	19 9
3 Underwriting of shares	6 9	7 6	0 4	14 5
4 Subscription to shares and bonds of financial institutions[1]	2 2	1 7	2 2	1 7
5 Rediscounting of bills	0 1	2 2	0 1	2 2
6. Guarantee for loans and deferred payments	7 0	18 6	—	—
Total	57 5	88 7	23 9	51·4

[1] Excluding purchase of shares of the I F C.

Industrial Credit and Investment Corporation of India Ltd.

Unlike the Central and State Corporations the I C I C I. is privately owned It was incorporated under the Indian Companies Act on January 5, 1955 for the purpose of assisting industrial enterprises within the private sector of industry in India. In general, the Corporation is (i) to assist in the creation expansion and modernization of such enterprises (ii) to encourage and promote participation of private capital both internal and external, in such enterprises , and (iii) to encourage and promote private ownership of industrial investments and the expansion of investment markets In particular it is (a) to provide finance in the form of long or medium term loans or equity participations (b) to sponsor and underwrite new issues of shares and securities (c) to guarantee loans from other private investment sources (d) to make funds available for re investment by revolving investments as rapidly as prudent , and (e) to furnish managerial technical and administrative advice and assist in obtaining managerial technical and administrative services for Indian industry

The authorized capital of the Corporation is Rs 25 crores divided into 50 000 ordinary shares of Rs 100 each, and 20 00,000 unclassified shares of Rs 100 each [1] The issued and paid up capital is held jointly by Indian banks and insurance companies and individual investors in India, the U K and the U S A Each share entitles its holder to one vote

Unclassified shares may be issued by the Corporation with a preferential or qualified right to dividends and in distribution of the assets and with a special right of voting or without any such right However, no shares can be issued without the sanction of the company in general meeting (i) unless they are offered to the existing shareholders in proportion to the shares held by them (irrespective of the class of shares) and (ii) if the aggregate nominal amount of preference shares issued exceeds the aggregate nominal amount of the issued ordinary shares of the Corporation

The Corporation is empowered to borrow, provided the amount borrowed and guaranteed by the Corporation, does not exceed three times the aggregate of (i) the unimpaired capital, (ii) the outstanding advance from the Government of India, and (iii) the surplus and reserves of the Corporation

After the expiry of five years from its incorporation, the Corporation was required to transfer 25% of its profits every year to a Reserve Fund to meet contingencies and for other purposes conducive to the interests of the Corporation until the Reserve Fund was equal to the outstanding Government advance

The Government of India advanced to the Corporation in January 1955 a sum of Rs 7 50 crores, free of interest, repayable in 15 equal annual instalments after the expiry of 15 years from the

1 The shares of the Corporation are approved investment for the purpose of Section 27 A of the Insurance Act, 1938.

date of advance The advance will rank for payment only after payment of all outstanding debts and liabilities and the paid up share capital of the Corporation , each annual instalment as it falls due will, however, be treated as a debt of the Corporation and not as part of the advance outstanding So long as there is any advance outstanding, the Government of India will be entitled to appoint, maintain and remove one Director on the Board of the Corporation to represent it , this Director will neither be liable to retire by rotation nor be required to hold any share qualification In addition, the Government of India agreed to lend the Corporation Rs 10 crores, from the proceeds of the United States Agricultural Commodities in India in October 1959 and a further loan of Rs 10 crores out of the P L 480 Funds in 1963, making a total of Rs 27 50 crores

The Corporation has borrowed in foreign currencies from international agencies as follows

I B R D In terms of Agreements dated

March 14, 1955	for U S $ 10 million
July 15, 1959	for U S $ 10 million
October 28, 1960	for U S $ 20 million
February 28, 1962	for U S $ 20 million
June 5, 1963	for U S $ 30 million
May 28, 1965	for U S $ 50 million

Agency for International Development of U S A In terms of Agreement dated

March 23, 1961	for U S $ 5 million

K F W (Reconstruction Loan Corporation) of Germany In terms of Agreement dated

April 26, 1963	for DM 20 million
July 27, 1964	for DM 5 million
Nov 23, 1964	for DM 10 million
June 8, 1965	for DM 5 million
March 23, 1966	for DM 20 million

The foreign currency loans amount to 158 65 million U S dollars (Rs 118 99 crores) comprising U S $ 140 million from the World Bank, U S $ 5 million from the Agency for International Development of U S A and DM 60 million from the Kreditanstalt fur Wideraufbau (Reconstruction Loan Corporation of W Germany) Repayment of the principal, interest and other charges on these loans have been guaranteed by the Government of India

Thus, the total resources of the Corporation on 31st December 1966 amounted to Rs 115 72 crores as detailed below

Share capital	Rs	7 50	crores			
Reserves	Rs	3 37	,,			
Borrowing Limit				Actual Drawings		
Rupee Currency	Rs	37 50	,,	Rs	29 50	crores
Foreign ,,	Rs	120 00	,,	Rs	27 92	,,
Total	Rs	168 37	,,	Rs	57 42	,,

Both the Government of India and the Corporation are of the opinion that the membership of the Corporation should be broadly distributed and that there should be no undue concentration of control. To ensure this, the Board of Directors exercise their rights with respect to registration of transfer of shares so as to prevent any one person or company or group of affiliated persons or companies from acquiring effective control of the Corporation. Any dispute between the Government of India and the Corporation as to whether effective control of the Corporation has been acquired may be referred to arbitration.

The Corporation sanctioned by the end of Dec. 1966, net financial assistance aggregating Rs. 178 crores to 425 companies, of which 179 were new companies. Companies to whom assistance was sanctioned were well distributed over the whole country. Out of this amount of Rs. 178 crores Rs. 141.35 crores (79%) were in the form of loans and guarantees, Rs. 30.58 crores (17%) in respect of underwriting of shares and debentures and Rs. 6.07 crores (4%) in the form of direct subscriptions to shares and debentures. Of the total loans of Rs. 141.35 crores sanctioned by the end of 1966 rupee loans accounted for Rs. 36.92 crores and loans in foreign currencies for the balance of Rs. 104.43 crores. 74% of the loans sanctioned by the Corporation were in foreign currency. Financial assistance provided in the form of rupee loans and by underwriting was almost equal to foreign currency loans.

Financial assistance (Net) provided till 31st Dec. 1966

(Rupees in crores)

Type of operations		*No. of companies*	*Amount sanctioned*	*Amount disbursed*
1	LOANS AND GUARANTEE			
	Rupees	113	36.92	25·99
	Foreign exchange	291	104.43	71.08
	Total	404	141.35	97.07
2	UNDERWRITING			
	Ordinary shares	97	13.15	6.40
	Preference shares	49	6.61	3.27
	Debentures	30	10.82	5.09
	Total	176	30.58	14.76
3	DIRECT SUBSCRIPTION			
	Ordinary shares	50	3.91	3.76
	Preference shares	7	0.66	0.61
	Debentures	2	1.50	1.50
	Total	59	6.07	5.87
	Grand Total	639	178.00	117.70

In regard to loan operations it is of interest to note that rupee loans have not recorded much progress but loans in foreign currencies have continued to expand. This pattern of assistance is due, to some extent, to the existence in the country of several institutional agencies which specialize in the provision of rupee finance while this Corporation is the only institution on account of its close association with the World Bank and other foreign agencies which enable the Corporation to disburse loans in foreign currencies.

The industries benefited from the Corporation's assistance so far cover a wide range. These include metal products (ferrous and non-ferrous), chemicals and products, machinery manufacture, electrical equipment, paper and pulp, cement, automobiles and cycles, textiles etc., as shown below.

Industrywise distribution of financial assistance

(Rupees in crores)

	Industry	*Net amount sanctioned*	%
1	Metal products (ferrous & non ferrous)	40 28	22 7
2	Chemicals and products	29 80	16 7
3	Machinery manufacture	19 41	10 9
4	Electrical equipment	16 93	9 5
5	Paper and pulp	9 84	5 5
6	Cement	11 95	6 7
7	Automobiles and cycles	10 02	5 6
8	Textiles	11 70	6 6
9	Glass, pottery, etc	7 03	4 0
10	Electricity, gas & steam	4 73	2 7
11	Shipping	3 49	2 0
12	Sugar	2 72	1 5
13	Rubber products	1 76	1 0
14	Wood, cork, etc	2 01	1 1
15	Food products	2 34	1 3
16	Oil pipe line	1 50	0 8
17	Others	2 49	1 4
	Total	178 00	100

Maharashtra received the largest share (37 4%) of the financial assistance, followed by Gujarat (13 4%), Madras (11%) and West Bengal (9%), the four states receiving two-third of the total assistance as shown below.

Statewise distribution of financial assistance

State	*No of companies*	*Net Amount sanctioned (Rs in crores)*	*% Shares*
Maharashtra	154	66 53	37 4
Gujarat	73	23 92	13 4
Madras	42	19 67	11 0
West Bengal	49	16 00	9·0
Mysore	20	12 39	7·0
Andhra Pradesh	12	9 04	5 1
Bihar	13	7 62	4 3
U P	15	5 67	3 2
Orissa	7	4 09	2 3
M P	6	3 42	1·9
Punjab	1	0 10	0 1
Assam	3	1 09	1·1
Rajasthan	6	2 37	1 3
Kerala	9	1 96	1 1
Haryana	10	2 29	1 3
Union Territories	5	1 03	0 5
Total	425	178 00	*100*

The Corporation functions more or less as a development bank and as such it has a long term contribution to make in an economy like ours As a development bank, I C.I C I seeks to foster investment on healthy lines, in times of sluggishness in the capital market, it provides funds to enable the flow of investment to continue, in normal times, it carries out scrutiny of projects, guides entrepreneurs about their projects It has made special efforts to assist new entrepreneurs, to take up riskier forms of financing like underwriting and to invest in non-traditional industries Many projects financed by the Corporation have been started by entrepreneurs for whom these projects were the first step in the industrial field The new entrepreneurs have come from a variety of fields—trading, management, engineering, etc. The Corporation also provides various ancillary services to new entrepreneurs

The Corporation has worked in close co-operation with other institutions in financing industrial enterprises It has joined other financial institutions in underwriting operations and in the granting of loans and it is proposed to discuss the possibilities of further combined operations with finance corporations, credit institutions and the Life Insurance Corporation, as well as with foreign institutions such as the International Finance Corporation and the Commonwealth Development Finance Company

The Corporation has also extended and strengthened its relations with sister development banks outside India (Malaya, Thailand, Liberia) and the General Manager of the Corporation attended in October 1963 the Second Regional Conference of Development Banks in Asia.

Unit Trust of India The Unit Trust of India was set up in December 1963 under an Act of Parliament as a public sector organization having been sponsored and supported by the Reserve Bank the Life Insurance Corporation and the State Bank of India It began to function in Bombay from 1st February, 1964 The *primary object of the Trust is twofold to stimulate and pool the* savings of middle and low-income groups and to enable them to share the benefits and prosperity of the rapidly growing industrialization *in the country This twofold objective is achieved through* a threefold approach first by selling units of the Trust among as many investors as possible in different parts of the country, then by *investing the sale proceeds, together with the Trust s own funds*, in industrial and corporate securities and finally by paying dividends to those who have bought the units of the Trust

The initial capital of the Trust is Rs 5 crores and has been contributed by the Reserve Bank, the L I C, the State Bank of India and its subsidiaries, scheduled banks and other financial institutions The Unit Trust of India Act provides that at least 90% of income less expenses, which are limited to 5% of the gross income, should be distributed to unit holders The Trust aims to give an average yield of over 6% to its unit holders During the first year of its working the Unit Trust declared a dividend to the unit holders of 6 10% per annum and of 7% during the second year Since the income from the Trust up to Rs 1,000 is free of tax, the gross rate for *individuals works out to* 7 62% *per annum* The Trust claims to offer the following further advantages to its investors

(1) In the case of individual unit holders, income up to Rs 1,000 distributed by the Trust is exempt from income-tax

(2) It will also be excluded in computing total income for purposes of assessment

(3) Individual unit holders will receive their dividend without any deduction of income-tax at source

The unit holder receives a steady income on his investment since the return is based on the average income of a balanced portfolio For the sale of units, the trust has organized a network of over 4 000 offices all over India, of the commercial banks (including the State Bank of India and its subsidiaries) which have contributed to the initial capital of the Trust Besides approved Brokers on the recognized Stock Exchanges, nearly 14,000 post offices throughout the country also act as agents for the sale of units The Trust has also set up three Regional Offices at Calcutta, Madras and New Delhi Units can be purchased in 10 or a multiple of ten There is no limit to the investment that one may make in units

The Unit Trust has emerged as a very important institution of industrial finance Three fourths of the total funds of the Trust are invested in shares and debentures of industrial concerns (ordinary shares 41 3%, *debentures* 42 1% and preference shares 9 7% and

2 7% bonds of public corporations accounted for the investments of the Trust) The Unit Trust invested its funds in the securities of over 250 industrial enterprises, mainly manufacturing, financial and public utility concerns The Trust has also embarked, in a limited way, upon providing underwriting facilities for new issues of debentures and preference shares by established enterprises. The Trust contemplates other types of schemes such as high income, Capital Growth Schemes and Savings Plan including Children's Gift plans for catering to the investment preferences of the various classes of investors and it is expected that the Trust will be able to tap a significantly larger volume of savings in the future and to divert them for rapid industrial development under the Fourth Five Year Plan

The Trust Act has been amended to enable the Trust to borrow from the Reserve Bank or the commercial banks against ordinary industrial shares and to offer additional facilities for acquisition of units by investors under new schemes catering to their special preferences or requirements The Trust would formulate schemes intended for the benefit of people interested in securing an element of protection in the form of insurance in collaboration with L I C or in the appreciation of the capital attributable to their subscriptions or the reinforcement of income which they might be currently earning

Finance Corporations and the Capital Market

The finance corporations set up since independence have contributed substantially towards the development of an organized capital market in India. Investment activity has been assisted by the strengthening of the institutional structure by the establishment of the I F C in 1948 the State Finance Corporations in each of the 15 states (during 1949–60), N I D C in 1954, I C.I C I and N S I C in 1955 and Refinance Corporations in 1958 (merged with I D B in 1964) and I.D B I in 1964 Not only has the volume of assistance provided by these financial institutions recorded a significant increase in recent years, but the emergence of some of these institutions has also led to the expansion of underwriting activity. *Institutional finance, in recent years, has constituted an increasingly important source of medium and long-term funds for Indian industry.* The volume of assistance provided by the various term-financing institutions (I F C , S F Cs , I C.I.C.I and R.C.I) represented about 5% of the total private sector investment in industry during the Second Plan in the Third Plan period, this assistance (including I D B I's) has been placed roughly at 13% of a larger total amount of investment. In the Fourth Plan Period, this ratio may again go up to some extent. The financial assistance sanctioned during 1964-65 and 1965-66 has been Rs. 118 2 crores and Rs. 166 6 crores respectively as shown below

Financial Assistance to industrial concerns sanctioned by major term-financing institutions

(Rupees in crores)

Institution	1964-65 Loans	1964-65 Under-writings and direct subscription	1964-65 Total	1965 66 Loans	1965 66 Under-writings and direct subscription	1965 66 Total
I D B I	18 3	3 0	21 3	58 8	10 5	69 3
I F C	20 8	3 8	24 6	37 7	5 8	43 5
I C I C I	16 8	6 3	23 1	18 8	5 8	24 6
S F Cs	20 0	2 8	22 8	23 4	1 9	25 3
S I D Cs	0 2	2 3	2 5	0 3	1 4	1 7
U T I	—	8 9	8 9	—	2 2	2 2
L I C	1 3	13 7	15 0	—	—	—
Total	77 4	40 8	118 2	139 0	27 6	166 6

The progressive strengthening of the financial machinery for provision of term finance to private sector of industry and the setting up of the I D B I as the apex institution has resulted in significantly increasing the contribution of term-financing institutions to the industrial growth of the country

The Industrial Finance Corporation has enabled a number of new enterprises to establish themselves firmly and pay attractive dividends At the time the loans were sanctioned, these units either did not pay any dividends or paid low dividends The N I D C has emerged as the most important institution responsible for the *promotion of giant capital intensive concerns second only to managing agents* The I C I C I is the most important institution providing assistance in foreign currencies The L I C is the largest single institution in the sphere of underwriting of and direct subscriptions to shares and debentures

The Industrial Development Bank of India is an apex institution which co ordinates the activities of all institutions engaged in financing industrial development and enlarges their usefulness by supplementing their resources and widening the scope of their financial assistance At the same time it serves as a large financing agency and deals with all problems of industrial finance A special responsibility vests in the I D B I to ensure that the limited funds available for channelling through the term financing institutions would be *put to the best possible use* Assistance must be concentrated on areas where it would be most productive The operations of the *I D B I and those of other institutions would have to be selective*, directed especially towards the building up of efficient units, in priority sectors Attention should be concentrated on areas like fertilizers, petro chemicals, alloy steels, machine tools, cement, etc

While the term-financing institutions should play a significant role in the financing of industry, it is necessary to bear in mind that

in general their contribution can only be a subsidiary one It should be hoped that the atmosphere of gloom that prevails in the capital market since 1963 will be a passing phase In the ultimate analysis the resources for both the public and private sectors have to come from the genuine savings of the public Fiscal policies and operations of the corporate sector have to be such as to maximize private saving and investment

The State Industrial Development Corporations (S I D Cs) have recently been set up in the states of Andhra Pradesh Bihar Gujarat Kerala Madras M P Maharashtra Mysore Orissa Punjab and Uttar Pradesh They have been established by state Governments in order to accelerate the tempo of industrial growth They provide assistance to industry either directly or indirectly in the form of loans issue of guarantees and assisting underwriting of shares and debentures Some of the S I D Cs have been entrusted with the task of developing and managing industrial estates A few of these can also engage in activities like the generation transmission and sale of electricity in specified areas They thus combine in their operations the functions of entrepreneurs financiers and welfare bodies Loans underwriting and direct subscription to shares and debentures sanctioned and disbursed has been as follows

	1964-65	*1965-66*
Assistance sanctioned	Rs 2 5 crores	Rs 1 7 crores
Assistance disbursed	Rs 1 3 crores	Rs 1 4 crores

10

Investment Banking & Underwriting

Investment bankers act as middle men between the savers and users of capital In business the middle-men act in two capacities, they act either as merchant middle-men, when they assume the risks or as agents when they do not take the risks The merchants work on a basis of margin between the buying and selling prices and the agents work on the basis of a commission In the U S A the investment bankers are primarily engaged in the merchandizing of securities The brokers act only as agents, they buy and sell securities for the account of their clients and receive their remuneration in the form of a commission But the investment bankers purchase blocks of securities—bonds or stocks—for their own account for the purpose of selling them at a price higher than the purchase price Their remuneration consists of the margin between the buying and selling prices Investment bankers often act as brokers also, but mainly they are merchant middle-men engaged in the purchase and sale of new securities—both equity and debt

Underwriting in negotiated financing

Functions of the Investment Bankers—Primary and the most important function of the investment bankers is *capital formation* or the *raising of new capital* It is usually carried out in three ways (a) underwriting involving outright purchase and sale of securities, (b) underwriting involving guarantee of sale or stand by' arrangement, and (c) 'Best Efforts' selling

The most important and most commonly used method of all the three is the outright purchase and sale of securities

Origination. This method may be discussed here briefly The investment bankers keep themselves in close touch with people interested in new promotions in different parts of the country When they get the news of the possibility of the promotion of a new company through one of the sources of their information and intelligence, they at once try to contact the leading figures of the proposed floatation The organizers of the new company agree to entrust the business of underwriting the new issue to one of the investment bankers

This investment banker comes to be known as the *originating house*. This house undertakes a thorough study of the project to safeguard the financial interests, reputation and prestige of its own as well as of its associates likely to join the venture at a later stage. Due attention is paid and all possible care is taken to safeguard the interests of the would-be investors also. Usually the *investigations* for determining the soundness and feasibility of the projected enterprise involve time and expense and therefore, the originating house enters into a contract with the new company to give it an option of purchasing the new issue of securities if the results of the investigations are favourable.

The banker utilizes the services of a number of experts to determine the suitability of the new issue for the purposes of underwriting. The prospects of earnings and other financial expectations may be analysed and examined by accountants, the technical efficiency of operating the plant may be examined by competent engineers, the commercial and marketing aspects of the business may be examined by market analysts and other experts, and the legal aspects relating to the validity of titles to property or patents, the legal soundness of the documents of registration, the memorandum and the articles of association etc., and the fulfilment of the obligations under the laws and regulations of the country may be examined by legal experts.

Purchasing. In case the financial, technical, commercial and legal aspects of the proposition are found to be satisfactory a contract setting out in detail the terms of sale, allocation of expenses and the future relationship between the company and the banker may be drawn up. When large issues are to be handled the originating house invites a number of other investment bankers to join him in the deal. As there is no provision for sub-underwriting in the federal security law of the U S A, all those who intend to join in underwriting and in bearing the risk, join in the original purchase contract and they constitute what is known as the *Purchase Syndicate* or the underwriting group, and the outright purchase is called 'underwriting'. The originating house acts as a manager and gets a small fraction of the gross margin as a management fee. Along with the purchase of the issue the risk is assumed by the members of the syndicate.

The *internal organization* of fairly large-sized investment banking firm is quite elaborate. There may be different departments to deal with different types of securities just like the corporate department and the government bond department. On the functional plane there may be the buying department, the selling department, the syndicate department, the trading department, the accounting department and the research and statistical department. The function of the buying department is to keep in touch with the would-be issuers of the new securities through its network of finders or scouts to negotiate the terms of purchase and finally complete the deal. The syndicate department is concerned with the formation of the purchase group or syndicate and with the allocation of the blocks or quotas of

securities to the members of the syndicate The research and statistical department engages itself in the analysis of the securities underwritten or traded in and it also prepares up-to-date lists of the secretaries, treasurers or presidents of the institutions like the educational or charitable foundations and trade unions interested in the purchase of securities as well as of the individuals falling in certain higher income groups, who are likely to purchase securities On the basis of this information the sales department keeps itself in touch with the potential purchasers of securities and keeps the market ready for the absorption of a new batch of securities almost in advance of the finalization of an impending deal This department plays the most significant role in the quick disposal of the merchandise of the firm and consequently in its successful operations The trading department strives to maintain continuing markets in outstanding securities and the accounting department maintains the records of the transactions—purchases and sales—and of other connected matters

Selling In order to secure wide distribution and quick disposal of securities it is considered essential that the largest possible group of bankers participates in the selling effort Usually the members of the syndicate who have underwritten the issue sell it through their own organization and through the dealers For selling an issue of $ 200 million debentures two hundred thirty-five firms were associated with the syndicate organized by Messrs Morgan Stanley & Company in 1953 Sometimes a list of 'selected dealers' or 'selling group is also set up by the underwriting syndicate Portions of the issue are allotted to them and unsold portions of their allotment are taken up by them The syndicates are temporary organizations and in the case of less successful issues the unsold portions of the allotted share are taken up by the participants and the syndicate is dissolved But when an issue proves to be quite successful the syndicate is dissolved only after a complete distribution of the total issue

This seems to be the current practice with regard to the outright purchase of a new issue, although some of the writers have mentioned the organization of three syndicates to handle large issues The purchasing syndicate, according to them, is comparatively a smaller group, mainly consisting of the investment bankers of the same financial centre or the city where the issue has been underwritten The selling syndicate is a much larger group and includes among its participants investment bankers from most of the important financial centres of the country This is necessary for ensuring a quick and smooth disposal of the issue over a wide area The last group, according to these writers, is called a 'stand by' or a 'banking syndicate' The investment bankers included in this group are expected to contribute an agreed amount of fund towards the purchase price to be paid to the issuer in case the issue fails to move as quickly as expected All concerned feel a sense of great relief if the occasion to utilize the services of the last group does not arise Of course this group receives its share of the margin irrespective of the fact whether its services are utilized or not

Standby underwriting. As explained above, 'underwriting' in an outright purchase of an issue includes all the activities of the investment bankers from origination of the issue up to the time of the sale of securities covered by the underwriting agreement But the term underwriting' is also used to denote the activities of the investment bankers in a restricted sense in which it was used originally An investment banker or a group of them enters into an underwriting contract with the issuer as an insurer or as a 'stand by' if the issue does not sell according to expectations He simply guarantees a successful sale of an issue, he does not buy or distribute the securities This type of work is undertaken in connection with 'rights' issues of securities to existing shareholders of equity securities The risk involved in the case of such an issue is that on account of certain unfavourable changes in the prices of securities offered to the existing shareholders, the right of purchase may not be exercised and the sale of new securities may fall short of the expected success and the company might have to face an embarrassing situation The investment banker steps in to underwrite the success of the issue He enters into a 'standby' agreement to take up that portion of the issue which remains unsold on account of the failure of the existing shareholders to exercise their priority right of purchase The same type of arrangement may also be made to cover the risk involved in the process of converting bonds or preference shares into equity shares When the redemption notice is given it may be advantageous to the bondholders to convert their holdings into equity But if in the meantime the prices of the equity shares decline to a point where redemption for cash may be considered better than conversion into equity securities, the bondholders might ask for payment in cash Such a situation is likely to create the problem of finding funds to pay for the bonds which have been called in for redemption Insurance against this type of contingency might be provided by an underwriting agreement with the investment bankers to provide funds for such securities as may be presented to the company for redemption in cash

Best Effort Selling. In this type of arrangement the investment banker acts purely as an agent. In an outright purchase or in a standby contract the banker assumes a good deal of risk , he may be called upon to take up the unsold portion of the issue and to pay cash for it In the 'best effort' selling agreement no such risk is involved as the banker makes no commitment to take up the unsold portion of the issue The company also has no assurance or guarantee that the entire issue will be sold and the total funds would be made available to it The banker simply gives an undertaking to do its best to sell the issue through his own organization or with the help of his associates The commission charged for this type of service will be lower than that payable in outright purchase or in standby arrangement This kind of arrangement may be made under two opposite type of conditions In the first case the company may be almost a super solvent unit and may be sure of obtaining at least short-term accommodation under easy

market conditions prevailing at the time by adopting the alternative of arranging a bank loan. In the opposite type of case the company may be a weak one or it may be requiring funds for a speculative undertaking like a mining enterprise and as such no investment banker of reputation may be prepared to assume the risk of an outright purchase or of entering into a stand by agreement. Some bankers, however, may be prepared to make best efforts to sell the issue on a purely commission basis without making any commitment to guarantee or insure the sale of entire issue. The bankers are under no obligation to take up the unsold securities and to provide cash.

Underwriting in competitive bidding

The foregoing discussion is concerned with underwriting procedure in negotiated financing, where the issuer and the investment banker or a group of them settle the deal among themselves privately. But competitive bidding for security issues has also assumed considerable importance. It was used in a small way as early as 1870, but it acquired importance and impetus since 1941 on account of competitive bidding made compulsory by the Securities and Exchange Commission for all companies, with certain exceptions, which came under its jurisdiction. The same rule was adopted by the Inter-State Commerce Commission a little later. The rule applies mainly to public utility companies although some of the industrial companies follow the rule of their own accord. Under this procedure when the investment bankers come to know of an issue to be taken up for underwriting on the basis of competitive bidding they form themselves into groups each under a group manager. The house which acts as a group manager occupies the position of an originating house. The members of each group hold consultations among themselves and the manager prepares the tender. Effort is made to offer as high a price for the issue as seems to be practicable. Just after the registration of the new company the necessary papers are sent to group managers who are in contact with the company. Sealed tenders are submitted, which are opened by the directors of the company and the contract is awarded to the highest bidder. After this stage the remaining procedure followed for the disposal of the issue is the same as applies to negotiated deals. The issue is bought, the purchase contract is signed by the group manager and the sale of securities is handled in the same way as is done in a negotiated deal. The system of competitive bidding has been introduced by the State and Federal authorities to check the development of monopolistic tendencies in the investment banking business. These fears of the authorities do not seem to be well founded on account of the existence of certain other factors and tendencies which are being mentioned briefly in the following discussion.

Direct Sale. The most important development in this direction is the adoption of the 'direct sale' or 'private placement' method of the sale of new securities by an increasingly large number of companies

This method is preferred by certain companies because in the first place the inconvenience in connection with the registration of the issue with the Securities and Exchange Commission is avoided the twenty days waiting period before selling the issue is also avoided Secondly there are also savings in the costs of underwriting and publicity Thirdly favourable atmosphere is created for direct sale by the willingness of institutional investors like the insurance companies with vast investible funds to take up the issue sold directly by the issuers This practice has become quite common in connection with the sale of bond issues where bonds for more than 50 per cent of the total amount of bonds issued are sold directly Direct sales are less prevalent in preference share issues and are still less prevalent in common stock equity share issues Sometimes the services of the investment bankers are utilized in arranging direct sales purely on a commission basis The other developments which go against the establishment of monopolistic conditions in the sale of new issues by the investment bankers are the increasing use of the retained earnings by the companies through the device of the issue of bonus shares and the use of rights issues for raising further equity capital from the existing shareholders

Sale of outstanding securities It was pointed out earlier that the primary function of the investment banking is capital formation through the sale of new securities. Besides this they engage themselves in distributing widely the large blocks of outstanding securities held by institutions like investment companies or officers of the companies like directors They also help in the exchange of securities between the corporations at the time of mergers or in the transfer of the securities of a subsidiary company from the ownership of the holding company to individual investors They help the investment trusts to replace one type of security with another type, act as brokers or dealers on the Stock Exchanges and offer technical advice and services to their clients.

Classification of Investment Bankers

Formerly the investment bankers were classified on the basis of the class of securities handled by them, as for example, the bankers who were mainly dealing in bonds were called 'bond houses' They are also classified on the basis of certain specialized functions performed by them. Those bankers who purchase the securities for selling them to other houses for distribution to the public are called 'wholesalers' The banker who purchases the securities on his own account and risk and sells them to the investors is called an 'underwriter' and a 'distributor' both. The bankers who do not belong to the merchandizing group engaged in buying or underwriting but who usually sell from the list of larger houses on the basis of a discount are known as 'dealers'. But this type of specialization of functions is giving way to a general type of business and most of the investment bankers undertake all types of activities at all the three levels and

also act as brokers Under these conditions they are now placed in three broad groups on the basis of territory covered or the size of business undertaken The big investment banking houses located in cities like New York and Chicago, who usually form purchase groups to buy large issues for wide distribution on the national level and are members of the leading Stock Exchanges are known as National Underwriters *The second type of bankers who carry on their business in major cities, act as originators of small local* issues or join hands in underwriting the issues of national importance, are usually called local 'underwriters In the third category those bankers are included who undertake to sell a part of the major security issues purchased by big houses, without assuming the risk They are called local dealers'

The foregoing discussion relates to the typical type of institutions engaged in the business of underwriting of new issues in the U S A These institutions are called investment bankers The U S A represents the most highly industrialized society of the world Similar conditions are not found in any other part of the world Consequently such highly specialized type of institutions are also not found elsewhere *But similar type of work of dealing in new securities is carried on by other types of institutions known by other names* In the United Kingdom similar type of work is undertaken by institutions called 'issue houses'

The issue houses help the companies in issuing new securities in a number of ways *If the issue to be made is a substantially large one say £ 3 million or more, the securities may be sold as a public issue by prospectus* The issue has to be properly publicized and an organization has to be set up to deal with a large number of applications and to allocate the amount available among them if the issue is over-subscribed The provision of this type of organization is one of the main functions of an issuing house A thorough investigation of the chances of the financial success of the company, reputation of the management etc , is undertaken by the staff of the issuing house *The best issuing houses are always very careful about their own reputation and consequently, however tempting the* commission offered them might be, they are not willing to sponsor an issue unless the issuing company is controlled by men of reputation and has good prospects of success In a new issue the cost of the exploratory and 'vetting' work done by the issue house is a substantial part of the total costs incurred by it in arranging the sale of such an issue When the financial and other information drawn up by the company *with the help of accountants, auditors, valuers, engineers and other experts and supplied to the issuing house has been* examined carefully and the results of the investigations are considered satisfactory, the issuing house agrees to pilot the issue The usual procedure followed by the issuing house is to underwrite the issue itself and then to invite a number of other financial institutions to sub-underwrite a part or whole of the issue The underwriter and the sub-underwriters undertake, for a commission, to buy the

unsold securities which could not be disposed of to the general investing public. The sub-underwriters are usually financial institutions like investment trusts or insurance companies. A good list of first class underwriters is a valuable part of the goodwill of an issuing house of reputation; similarly to be on the lists of one or more first class issuing houses is a good privilege for a financial institution. Both are mutually beneficial to each other. Usually the issues sponsored by issuing houses of good reputation are fully subscribed; the sub-underwriters earn their commission for the risk assumed by them and are released from their obligation. On relatively rare occasions they may be obliged to take up a part of their share in the issue. Under this method the issuing house and the sub underwriters have only guaranteed the success of the issue for a commission and have agreed to purchase the unsold shares at issue price less commission.

An alternative method is called an 'offer for sale'. In this case the issuing house purchases the new securities from the issuing company and offers them for sale to the public at price which is sufficiently higher than that paid to the company. The sale price includes the expenses incurred by the issuing house as well as a margin of its profit.

In the 'offer for sale' the securities are offered for sale to the public. But in certain other cares where the size of the issue is between £ 1 5 and £ 3 million, not considered sufficient to form the basis of a public issue, an issuing house buys the whole issue outright and then resells it at a higher price to groups of investors like the investment trusts and insurance companies. The difference between the buying and selling prices is sufficient to cover the expenses and then leave a reasonable margin of profit for the risk taken. In this case the sale is not to the public but to the groups of institutional investors. In the case of outright purchase buying syndicates may be formed. For outright purchase the term 'underwriting firm' is also used. The functions performed by issuing houses in England seem to resemble those performed by originating houses in the United States. The general organization and working of English underwriting and issuing houses appears to be far less elaborate in comparison to the organization and working of the investment bankers in America. The organization in India is not even a shadow of what is to be found in the U S A or the U K.

The process of modern industrialization began in India as late as 1850 and almost up to the time of the first World War (1914-18) the long-term finance was usually obtained with the help of managing agents. The intermediaries like the investment bankers or the issuing houses did not develop in India till quite recently. It appears that the process of underwriting of capital issues was initiated in India just on the eve of the first World War. In 1912 Messrs Batliwala and Karani (share brokers of Bombay) underwrote a capital issue of Rs 50 lakhs made by the Central India Spinning &

Weaving Co Ltd, in 1913 Chunnilal Saraiya underwrote a cumulative preference share issue of Tata Mills Ltd Messrs Batliwala and Karani continued to underwrite the new issues during the period of the first World War Most of the capital issues underwritten involved little risk as they were made by the companies under the management of managing agents of reputation and standing The amended Companies Act of 1936 took notice of the underwriting activities for the first time when it laid down that it was necessary to state in the prospectus of the new company that in the opinion of the Directors the financial resources of the underwriters were sufficient to discharge the underwriting obligations

The first important institution to take up the issue business was the Investment Corporation of India Ltd, established by the Tatas in 1937 The main object of this institution was to take up issue and underwriting business on scientific lines, to carry on the business of an investment trust company and to take up the promotion and financing of new industrial concerns In the two important financial centres of Bombay and Calcutta a number of new institutions known as Investment companies and finance houses and companies were established to undertake the work of issue and underwriting or sub-underwriting of industrial securities The investment trusts have occasionally underwritten new securities but mainly they have been interested in sub-underwriting The number of these institutions has increased considerably during the last three or four decades In Bombay the Industrial Investment Trust Ltd was started in 1935 by Messrs Premchand Roychand & Sons, in Calcutta the Birds Investment Ltd and New India Investment Corporation Ltd were started in 1936 (Two other investment trusts, viz the Investments & Finance Co Ltd and the General Investment & Trust Co Ltd started by Messrs Bird & Co were already in existence in Calcutta at this time) These institutions were followed by numerous others of the same type in Bombay, Calcutta, Madras and in some centres in Northern India

The stock brokers also began to play an increasingly important role in the business of underwriting of new issues Names of Messrs Batliwala & Karani (Bombay), Messrs Place, Siddons & Gough, and Messrs Reed Ward & Co (Calcutta), Messrs Wright & Co Messrs Kothari & Sons and Messrs Newton & Co (Madras) deserve special mention in this connection

A few commercial banks also showed some interest in underwriting business The names of Central Bank of India Ltd and Devakaran Nanjee Banking Corporation Ltd may be mentioned in this connection

Since the establishment of national government in 1946, a number of state, semi-state or private financial institutions like the National Industrial Development Corporation, the Industrial Finance Corporation of India, the Industrial Credit & Investment Corporation and the Life Insurance Corporation have come to be established

They are all strong financial institutions but their main business is to provide long term loans to the industrial companies The companies borrow substantial amounts from these institutions on a long term basis The Industrial Finance Corporation, the Industrial Credit and Investment Corporation and the Life Insurance Corporation also undertake a considerable amount of underwriting business Besides the purchase of the shares and debentures of the companies, the activities of these institutions have given a great impetus to the growth and development of underwriting of industrial securities in India and some details of the business undertaken by them are given in the next chapter ('The Indian Capital Market) The methods of sale of securities have also been discussed in the same chapter

Services rendered by investment bankers, issuing houses and underwriters to the companies and to the investors

The various types of institutions engaged in the business of underwriting occupy the same position in the sphere of company finance between the companies which require funds for carrying on their activities and the savers and investors who provide these funds, as the merchant agent and middlemen occupy in trade and commerce They have to build up a reputation for fair and honest dealings useful to companies and investors to win the confidence of both the parties They have to help the companies in securing the required amount of finance on cheapest possible terms and in this process they have also to help the investors in acquiring a good and sound security likely to give them best possible returns under the existing market conditions Underwriters of good reputation are able to accomplish the twofold task

(1) The handling of a new issue, especially a large one, from its very origin up to its final successful distribution requires the setting up of an elaborate and specialized organization comprising people possessing specialized knowledge and skill to conduct business in the capital market For the companies long term financing with new issues is an infrequent occurrence and may take place only after long intervals To set up a specialized organization for handling new issues may be a very costly and uneconomic business for the companies But the handling of new issues is a routine affair for the underwriters , they possess the necessary special type of organization and are therefore in a position to accomplish the task of distribution of securities very cheaply

(2) The specialized type of selling organization consisting of their associates brokers and dealers is in a much better position to give the new securities the most satisfactory market,'and widest distribution at best possible prices

(3) The underwriters take upon themselves the responsibility of making the agreed amount of funds available to the company at an agreed date or time and thus eliminate the element of uncertainty and risk inherent in slow disposal or partial failure of the new issue

And in those cases where the issue is successfully distributed in a wide circle of good investors a potential market for the subsequent issues of the company is created which may prove to be helpful and advantageous both to the company and the investors

(4) Usually the people included in the top management of companies are very well informed on financial matters but the under writers are in more close and intimate touch with the capital market and are in a position to reduce to the minimum and reconcile the differences between the needs of the company and the requirements of the market—what the company wants to offer and what the mar ket is in a mood to accept This reconciliation is brought about by advising the company to select a right type of security and to offer it to the market at the right time In the case of credit securities like the bonds and debentures the form of protective provisions the arrangements for repayment, the sale price and the rate of interest are properly adjusted to the best advantage of the company and to meet the requirements of the market All these adjustments are essential to ensure the success of the new issue

(5) In order to safeguard their own self interest the under writers have to earn the goodwill of the financial community This enhances their prestige which becomes a very valuable asset in en suring a successful sale of the securities sponsored by them Included among their clients are a number of institutional investors like the investment trusts and insurance companies On the whole they are skilful and well informed buyers But majority of the individual investors are only moderately informed Their goodwill is secured by selling to them the type of securities which prove to be sound and which give the investors good and steady returns

To safeguard the interests of investors as well as to avoid the chances of financial loss to themselves the underwriters get the financial position of the issuing company thoroughly examined by their own independent experts before they underwrite the issue The security to be underwritten is also thoroughly examined by legal experts from the point of view of protective provisions and the legal requirements It is really the exercise of these checks which gives weight and prestige to the new securities sponsored by reputed houses of underwriters Investment advice is also given to the client investors with regard to the type of securities to be purchased This advice may be good but it may be poor also when it is coloured on account of the selfish motive of the underwriter in pushing the sale of a particular security

(6) One of the very valuable services performed by the under writers is the maintenance of the market for the security after its floatation Usually they accept these securities only for the purpose of underwriting which are of a suitable size to provide a good market for them Small issues are not able to satisfy this condition The cost of selling small issues is also proportionately higher After the floatation the underwriters take proper care to see that such large

blocks of the security are not placed on the market in a short period of time, which may depress the price of the security The maintenance of the market is in the best interests of all concerned—the investors, the company as well as the underwriters themselves

The entire discussion in this chapter leads us to the conclusion that the development of underwriting agencies is one of the essentials of healthy industrial development of a country In India we have just made a modest beginning and the country has to go a long way before it can hope to enjoy the benefits of a good underwriting organization

11

The Indian Capital Market

The capital market is the market wherefrom productive capital is raised and made available for industrial purposes It refers to the market for the permanent forms of investment such as shares and stocks, bonds and debentures and mortgages

The entire financial field or investment market[1] may be divided into two broad groups (a) the capital market, and (b) the money market The former refers to long term financing and the latter to short term lending The constituents of the former are the long-term financing agencies like the industrial and mortgage banks, the industrial finance corporations, the investment trust, the issuing houses, the company promoters, and the stock brokers, etc , while those of the latter are the commercial banks, the indigenous bankers, the private money lenders and the co operative credit institutions, etc

The capital market has nothing to do with capital goods , it is concerned with raising of money capital The commodity that is dealt within the capital market is long term money, that is, money which is either lent for long periods or is invested more or less perpetually

The Capital Market and the Money Market

A *business enterprise requires money for two purposes (i) for the purchase of capital equipment and other fixed assets, and (ii) for the holding of stocks of raw materials* and *finished goods and also for making payment of wages, etc The former requirement is referred to as fixed capital or long term capital, and the market for*

[1] The investment market, in its broadest sense, includes any form of commitment *into which savings may flow It would include not only the stocks and bonds* of business, the mortgages and equities in real estate and the debt of Governments but also bank deposits money, and even such things as jewels and postage stamp collections that have been acquired as a store of value Conventional discussion is usually limited, however to those forms of property that *produce a money income* (Ralph Eastman Badger and Harry G Guthmann, *Investment Principles and Practices*, 1959, p 17)

the provision of long term funds is the capital market. The market for short term money is called the money market.

Basically the capital market is similar to commodity market. (1) Like a commodity market the capital market has various sources of supply[1] and demand and these sources of supply and demand are variable rather than static. The variations in the supply and demand are, however, cyclical rather than seasonal as in the case of money market. (2) Secondly, just as the price is the heart of a commodity market, so also the price for the use of money (i.e. the rate of interest) is the heart of the capital market. (3) Thirdly, as in the case of commodities there is no single perfect capital market also. Though money is the most standardized commodity, the capital market is not a completely homogeneous one. There are different capital markets like different commodity markets operating all over the country, viz. the market for government securities, for industrial securities, for debentures, for long term agricultural credit, etc. (4) Consequently the rate of interest varies in different capital markets according to regional or cyclical variations in the demand and supply of capital and there is no such thing as a single rate of interest for the country as a whole. (5) Like a commodity market, the market for capital is also not always confined to the political boundry of a country. In the case of capital also movements across the border occur though such movements are subject to many restrictions like those of commodity imports and exports. (6) Lastly, as in the case of commodities an elaborate marketing organization, comprising various intermediaries, is required to transfer funds from the savers to those who require them for investment. These intermediares are the issuing and underwriting agencies, finance and stock brokers, and institutional agencies such as Life Insurance Corporations.

However, the physical part of the marketing organization is different from that of other commodities. There are no problems of warehousing, physical testing of quality, grading and transport, etc. Also unlike commodities which are consumed away, there is secondary trading all the time in the securities (shares and debentures) which are issued by those receiving the funds from investors.

Though, as already mentioned, the capital market includes all forms of permanent investments such as shares and stock, bonds and debentures and mortgages, yet in practice it is usual to confine it to the securities market, viz., the market for shares, stock, bonds and debentures etc. Secondly, it is also customary to limit it to the private sector of the industry wherefrom flows the money supply for this sector and ostensibly it excludes the demand for capital for the public sector. It is considered essentially an institution of a free economy.

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1 The principal sources of supply are the savings of individuals, of business corporations and of Governments.

Importance Although India has embarked upon the establishment of a socialistic society, the subject is of considerable importance to us Firstly, the precise nature of the socialist society of our own conception is not yet quite clear Secondly, it will take time before we are in a position to acquire our ideal of socialistic society The private sector in India has played a prominent part in the reconstruction of the country during the period of the first three Plans and is likely to play such a role in the Fourth and subsequent Plans also In any case, it has a considerable scope for its expansion

The capital market performs several important functions in the process of economic development The two primary functions are (i) promotion of savings and investment , and (ii) efficient allocation of funds among competing users

The major determinant of aggregate savings is, of course, national income, but the provision of certain incentives for investment can enhance total savings out of a given level of national income The capital market *provides such incentives* by creating a variety of financial assets and by ensuring their *liquidity* and *marketability* *It can thus help increase the propensity to save*

In the process of growth, the capacity to save, of certain classes of people and institutions, increases and they have varied asset preferences Their preferences also change from time to time The needs of entrepreneurs who actually use the savings for productive purposes are also varied The capital market *satisfies the 'tastes' of savers and needs of investors* through its financial instruments and institutions

In the First Plan period, out of a total investment of about Rs 3360 crores, investment in the private sector amounted to Rs 1800 crores or about 54% of the total In the Second Plan, out of a total estimated investment of Rs 6750 crores, the share of the private sector was estimated at Rs 3100 crores or about 46% The Third Five Year Plan envisaged total investment of Rs 10,400 crores, of which Rs 4100 crores was anticipated to be invested in the private sector Thus, though the share of government in total investment may rise, the magnitude of investment effort in the private sector will be considerable

Sources of Supply

The supply in the capital market comes from savings These savings may accrue from the following sources (a) individuals, (b) business corporations, (c) governments, (d) foreign countries, (e) bank credit, (f) provident funds, (g) financial institutions, etc

Individual Savings The individual savings constitute by far the largest source of capital, particularly in respect of equity capital, though one would notice the growing importance of institutional media in India and elsewhere in the world in recent years Individual savings find their way to bank deposits, small savings schemes of the

Postal Department or the Government Treasury, the Prize Bonds of Government of India, the Zamindari Bonds of the State Governments, the life insurance policies, and the industrial securities, etc A part of the individual savings is directly invested in housing, automobiles, ornaments, and household equipment, etc Individual savings in this country averaged at Rs 495 7 per annum during the First Plan period, at Rs 762 4 during the Second Plan period and at Rs 833 9 during the first two years of the Third Plan Nearly three fourths of the savings come from individuals in the country The ease with which industrial securities and government or semi-government loans have been floated in recent years goes to prove a rising trend of individual savings in this country also Important incentives to save may be stated briefly They are

(i) Provision for emergencies like illness, accidents, unemployment, etc

(ii) Accumulations for expenditure requiring a large outlay, viz., vacation, travel and purchase of large items, such as a house, an automobile, etc

(iii) The desire for the independence and financial opportunities associated with owning a business (i e, small or medium sized units owned by one or a very few individuals)

(iv) Desire for investment income.

(v) Provision for retirement or old age

Corporate Savings Where a part of the income of a business is left in the business and reinvested, the result is a saving just as truly as if such income were paid out to the owner stockholders and then reinvested from their personal incomes Such business savings are an important source of funds in India and elsewhere According to a study of the Reserve Bank of India, the *retained profits* averaged 39% of the net profits of 750 companies during 1951–55 [1] But a recent study of 1333 companies shows that retained profits during 1961–64 formed a small percentage of 20 of total profits and were only 18 8% in the year 1963-64

Government Savings Very often the Government is thought of only as a source of demand for investment of funds, but governmental units also affect the supply by their savings that result in the retirement of previously issued debt When a governmental body has a budgetary surplus and retires its debt, the resulting shrinkage in the supply of *investments* may be thought of as a negative factor on the demand side reducing the net figures rather than as an addition to the supply of available funds

The Government provides some financial assistance to industry through subscription to ordinary and preference capital as well as debentures and also through direct loans, though on the whole

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1 See head 'Self financing', chapter 8 (p. 155).

assistance of this sort is marginal in character except in regard to shipping and small-scale industries where it is substantial

Provident Funds Provident Fund is a compulsory saving primarily as a provision for retirement, but is largely drawn upon in many cases for construction of houses It is becoming a very important medium of saving, but it is mostly invested in government securities, government small savings and other trustee securities

Foreign Countries Foreign capital in the form of shares, debentures and loans or deferred accommodation has shown a growing importance during the period of our Five Year Plans The World Bank has contributed substantial amounts especially to the steel industry The U S A West Germany, Canada, Great Britain and Japan have rendered varied types of assistance to this country in recent years

Bank Credit Some people believe that bank credit creates investments to a certain extent and is thus a source of capital to industry indirectly The commercial banking system, if supplied with sufficient free cash reserves, can originate a credit supply

Financial Institutions A large number of financial institutions have sprung up in the post war period which bring a substantial amount of capital to the capital market in this country Though these institutions are simply a secondary source of finance, they are growing in importance as an intermediary between the savers and the actual users increasing thereby the supply of capital in the market The important ones among them are the Industrial Finance Corporation of India, State Finance Corporations the Industrial Development Bank of India, the National Industrial Development Corporation, the Industrial Credit and Investment Corporation of India the Unit Trust of India and the National Small Industries Corporation

Source of Demand

The largest part of the demand for capital comes from the industrial sector and predominantly from the manufacturing group We in India have two distinct sectors of the industry, the public sector and the private sector The demand of the private sector is fully met from the capital market, while that of the public sector from the State exchequer though government has also to rely for part of its demand on the capital market Governments (Central or State) in this country have borrowed extensively in recent years for development purposes The governments have been investing not only on such economic overheads as transport, irrigation and power development, but on basic and sometimes even consumer goods industries Agriculture in India is not much of a source of demand for capital In view of the small scale of agricultural operations, the demand for capital is met largely from the unorganized sector (i e , individuals and money-lenders) In countries like U S A , Britain and other advanced countries of the West there is little scope for further investment of capital at home Consequently a large

part of the demand comes from undeveloped countries of Asia and Africa

Constituents of Capital Market

The marketing organization of a capital market consists of various intermediaries responsible for the transfer of funds from those who save to those who require them for investment These intermediaries bring together the borrowers and the investors, that is, the companies that issue capital and the persons desirous of purchasing capital so issued There are two important operations carried on in the capital market (a) the raising of new capital and (b) trading in the securities already issued by companies The intermediaries which perform these twin functions are the constituents of the capital market *The efficiency of a capital market* depends largely on the specialization attained by these intermediaries In western countries, there is considerable specialization *to attend to the different stages in the formation of an enterprise and* raising of capital namely, promotion, issuing, underwriting and distribution of securities There are *Issue Houses* in the U K and *Investment Banks* in the U S A serving as specialized agencies for the promotion of new enterprises Besides, there are *the vendors, promoters, managing directors, underwriting agencies, finance and stock brokers* and *institutional agencies* such as *life insurance companies, investment trusts* and *finance corporations*, etc In India, such specialized agencies do not exist for the promotion of new companies, issue and underwriting of shares One important reason of the absence of such specialized agencies in India is the small volume of investment activity that characterized the Indian economy until recently Even a more important reason than the above is the existence in India of a unique institution, namely, the managing agency system, serving as a multipurpose organization for promoting an enterprise, for raising capital and also for managing it Conservative traditions of the commercial banking system, absence of private banking houses and poor development of institutions like investment trusts are other reasons for the backward organization of our capital market

The situation is now improving with the expansion of investment activity, awakening of investment consciousness among the people and coming into existence of several specialized financial institutions Thus the important constituents of the Indian capital market today are (i) Managing agents, (ii) Commercial banks, (iii) Special financial institutions, viz., (a) the Industrial Finance Corporation of India, (b) State Financial Corporations (c) the National Industrial Development Corporation, (d) the Industrial Credit and Investment Corporation of India, (e) Industrial Development Bank of India, (f) the National Small Industries Corporation, (g) the Unit Trust of India, (h) the Life Insurance Corporation, and (iv) the Stock Exchanges

Operations of the Capital Market

There are two important operations performed by the capital market

(a) Raising of new capital in the form of shares and debentures, and

(b) Trading in securities already issued by companies

According to the data collected by the Reserve Bank of India,[1] the total capital raised by all non-Government companies through shares (other than bonus issues) and debentures against consents as well as under the exemption order in three years and nine months (January 1957 to September 1960) amounted to an average of Rs 64 crores a year Similar capital issues during the four year period ending March 1965 (1961-64) amounted to Rs 98 4 crores a year

As regards the type of issues, of the total capital raised, 28% were in respect of *initial issues* of shares (i e, issues of new companies), 57% in respect of *further issues* of shares (i e issues by existing companies) and 15% in respect of *debentures* (the percentage share of shares and debentures being 85 and 15 respectively) during the period 1957-60, the corresponding percentages for the later period being shares (initial) 37, shares (further) 43 and debentures 20

As regards the type of security through which the total capital was raised, 76% was raised through ordinary shares in both the periods Debentures accounted for about 15% and preference shares for 9% during the former period and 20% and 4% during the latter period

There are 7 recognized stock exchanges in the country trading in securities of various types, viz, Bombay, Ahmedabad Madras, Calcutta, Hyderabad, New Delhi and Indore Besides there are a few other un-recognized stock exchanges also functioning in the country which afford facilities for the sale and purchase of industrial securities A detailed discussion is given at the end of this chapter

(a) New Capital Issues

1 *Methods of Floatation* There are four different ways in which new issues are floated in the capital market, viz, (i) prospectus method, (ii) offer for sale, (iii) private placing and introduction, and (iv) offer by circular to shareholders popularly known as the 'rights issues' The relative importance of these four methods depends on the nature of organization of the capital market concerned

(i) *Prospectus Method* The prospectus is the document whereby the public is invited to subscribe for shares or debentures of a company It is the most widely practised method in India The promoters include in the prospectus details of the proposed venture

[1] Reserve Bank of India Bulletin, Vol XV, No 2 (Feb 1961), pp. 165-86

and invite subscriptions from the general public on the basis of the terms and conditions contained therein This enables them to *approach a wide range of prospective shareholders; but since* prospective investors in a new company cannot be expected to possess a special knowledge of the venture, and have to base their decision primarily on the information in the prospectus, it is necessary to ensure that fraudulent promoters do not mislead them by *giving insufficient or false information in the prospectus* The Indian Companies Act requires the promoters and others responsible for the issue of the prospectus to disclose exhaustive information in the prospectus, a copy of which has to be filed with the Registrar of Joint Stock Companies The Act also throws heavy responsibility *on promoters or directors issuing the prospectus and holds them* liable for any false, misleading, ambiguous, fraudulent or deceptive statements made in the prospectus The subscribers get four clear days for the study of the prospectus before applying for the shares or securities of a company since no allotment is allowed before the *5th day from the date of the issue of the prospectus*

(*ii*) *Offer for Sale* It is an indirect offer for sale to the public, not by the issuing company, but by an intermediary The company, in the first instance, allots the whole or a large part of the shares to issue houses, sharebrokers, banks or other institutions or *financiers who in their own turn offer them for sale to the public* at a definite price This method is common in the U K, but not in India In this case also, particulars have to be provided in the same way as in the prospectus method This method is popular because it saves the company from all botheration and reduces the *cost and trouble involved in marketing new issues*

(*iii*) *Placing of Shares* The third method involves the placing of new issues privately with certain institutional investors followed by an application to the stock exchange for permission to list the security for transactions with a view to distributing them to the individual investors The prospective *shareholders can gauge* the soundness of the new issue from the status of the institutional investors with whom the securities are originally placed Two alternatives are open to the company concerned Firstly, the company may arrange with an issue house or broker for the purchase by it or him of *its securities and the issue house or broker 'places'* them with its or his clients who are a few selected firms, companies and institutions Secondly, the issue house may not purchase the shares from the company but may merely agree to act as agent to place the securities with its clients The issue house in this case mainly acts as agent for the disposal of the securities for a commission which it does privately instead of by a general public offer

This method is cheaper than the prospectus method since it involves very little in the way of promotion expenses But, there are possibilities of the method being utilized to the disadvantage of *prospective investors by unscrupulous* promoters because, although the total number of shares is known, the amount of shares held by

the institutional investors and those which are in the market cannot be separately ascertained, thus providing opportunity for the creation of artificial scarcity, manipulation and stagging It is *for this reason that the London Stock Exchange has looked with disfavour upon private placing and introduction* The Bombay Stock Exchange tried to minimize the scope for such practices by insisting on at least 50% of the new issues for which listing was sought being kept open for public subscription for at least three days, before proceeding to allot them to institutional investors Under rule 19 (2) (b) of the Securities Contracts (Regulation) Rules, 1957, at least 49% of the issued capital has to be offered to the public for subscription in the first instance, if a company is to be eligible for an official quotation on the stock exchanges recognized by Government under the Securities Contracts (Regulation) Act, 1956 When, however, there is participation by Government or foreign collaborators, their contribution is deducted from the total issued capital and public subscription has to be invited for at least 49% of the balance As a result of this requirement, the general practice has grown up for new companies to invite the public to subscribe for at least 49% of their capital by the issue of a prospectus and the balance is placed privately amongst friends and associates or with institutional investors or with or through stock brokers amongst their clients This procedure works satisfactorily on the whole Private placing *enables companies to make certain of obtaining a not significant portion of the finances needed by them and on the other hand public offering safeguards of the interests of investors who have an opportunity of participating in all important issues*

(*iv*) *Rights Issue*—Offer by circular to shareholders is possible only in the case of an additional issue of capital made by an existing company and not in the case of a new company The Indian Companies Act requires every company any time subsequent to the first allotment of shares to offer the new shares to existing *shareholders in proportion to their existing holdings* The offer is *made generally at a price which is lower than the value of the shares in the market.* Renounceable *allotment letters* may be issued to the existing shareholders and the shares will be allotted by the company either to the existing members if they apply or to the purchasers from them in whose favour the rights have been renounced This is called the 'Rights Issue' A 'rights issue' is different from a bonus issue A bonus issue does not raise any new capital It merely increases the nominal amount of the issued share capital by the company utilizing its undistributed profits in paying up for the new shares At times, it is provided that the portion of the new issue not taken up by the shareholders or their nominees would be offered for public subscription and in such cases a prospectus is simultaneously issued inviting the general public to apply for the shares

(*v*) *Conversion Issue* In addition to these four well known methods, there is a fifth one termed as the 'Conversion Issue' A company sometimes offers to its debentureholders, the right to

convert them into ordinary shares in lieu of redemption This is called the 'Conversion Issue'

2 *Underwriting* The promoters of a company are naturally anxious about the success of the issue of capital on which depends the future of the venture Generally, even before an issue is made public, the promoters will have done some canvassing among friends, relatives and business associates, etc, for the purchase of shares and it is customary to mention at the time of issue that specified number of shares will be allotted to friends and associates, the balance being available for public subscription In respect of the shares offered to the public, a device is available to the promoters to ensure success of the issue This device is underwriting The underwriters, in return for a consideration, undertake to purchase the shares not taken up by the public Thus, underwriting is a method by which a company ensures that the whole of the issue or at least a part of it to cover the amount of minimum subscription is taken up

A company may have very bright prospects of the success of an issue but some events may intervene as a result of which applications from the public may not materialize to the extent expected. For instance, political or other unpredictable events may throw out of gear the capital market Unfavourable and uncharitable news paper comments may be made against the company issuing the shares Or it may be that at the same time a very attractive floatation is made by some other company Failure of the issue owing to such unforeseen causes will mean in the case of a new company that it cannot allot its shares as even the minimum subscription may not be subscribed and in the case of an existing company wanting to expand, its creditworthiness will be seriously jeopardized To guard against such a contingency, steps are invariably taken by companies to enter into an underwriting contract Ordinarily the expectation is that the very fact that an issue is underwritten, carries with it a confidence for the investor and the securities should sell easily, particularly where the underwriter is a reputed firm or institution However, the underwriters have to take up the balance not taken up by the public

Unlike the U K and the U S A, there are no specialized agencies of underwriters in India Firms of stock brokers, a few of the larger scheduled banks, insurance companies, two or three investment trusts and some individual financiers participated in underwriting business on an *ad hoc* basis till before 1955, and cases of true underwriting of capital issues occurred only sporadically There was no institution doing regular business of underwriting Underwriting operations were undertaken by a few big firms of stock brokers as a side line to their main business of brokerage, their activities being pronounced during the periods of stock market boom A study by Mr R C Cooper of 40 issues underwritten during 1946 revealed that nearly half of them were underwritten by stock brokers

During the war and early post war years, underwriting in India was also subject to certain abuses In some cases, under-

writing was not done in the real sense of the term of accepting the liability *for taking up the unsubscribed part of shares but it was* merely a device to pay commission to some parties on the issue of capital But things have changed in recent years and suitable provisions have been made in the Indian Companies Act to prevent malpractices in underwriting The most important event in this field has been the setting up of the Industrial Credit and Investment Corporation of India Ltd (January 1955), the Unit Trust of India (February 1964) and the Industrial Development Bank of India (July 1964) Since then some progress has been possible in the organization of underwriting facilities for corporate issues of capital Now, apart from banks and brokers, underwriting operations are carried on by the Life Insurance Corporation of India, U T I, I C I C I, the Industrial Finance Corporation of India, I D B I and many other institutions Mr L C Gupta made a detailed study of all *the corporate issues advertised in The Times of India*, Bombay during the period from January 1951 to June 1959 The study was confined to the underwriting of public issues only and 'rights' issues were excluded The study, which was published in the Annual Number of Commerce in Dec 1959, revealed that the amount underwritten during the period from January 1951 to December 1954 was only 5 8% of the amount actually offered for public subscription, but that the amount underwritten during the period January 1955 to June 1959 was 38 9% of the amount offered This improvement during the period 1955—59 was ascribed to two important developments firstly, the setting up of the I C I C I in January 1955, and secondly, *the increased interest taken by banks and other agencies* in underwriting operations as a result of a better climate in the field of investment

The study disclosed that *commercial banks as a group emerged as the most important underwriters* accounting for 39% of the total amount underwritten during January 1955 to June 1959[1] *Considered singly, however, the I C I C I was the most important underwriting institution* accounting for 35 6% of the total amount underwritten Thus, the banks and I C I C I together underwrote nearly 75% of the total amount underwritten and the balance of 25% was shared by stock brokers (6 7%), insurance companies (including L I C, 5 3%), investment companies (6 3%), the I F C (3 4%) and others (3 7%)

According to the Reserve Bank of India, the percentage share of different financial institutions in underwriting new capital issues in recent years is given below[2]

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[1] The banks which participated in these underwriting operations were the Central Bank, the Union Bank the Baroda Bank, the United Commercial Bank and the United Bank of India

[2] Reserve Bank Bulletin, June 1964

Institution	*1960*	*1961*	*1962*	*1963*	*Total (1960 63)*
Brokers	22 4	38 3	22 6	31 0	28 1
L I C	11 2	11 7	33 1	14 6	20 4
Banks	37 8	11 3	15 6	17 0	18 7
I C I C I	12 2	3 7	9 3	9 6	8 5
I F C	2 6	8 6	9 2	9 8	8 1
S F Cs	1 3	12 9	1 5	10 1	6 0
Investment Cos	9 7	5 2	3 0	1 8	4 4
Others	2 8	8 3	5 7	6 1	5 8
Total	100 0	100 0	100 0	100 0	100 0

The establishment of the Industrial Development Bank of India (July 1964) and the Unit Trust of India (February 1964) has changed the situation since both of them have emerged as very important underwriters The relative share of different underwriters during the calender year 1965 was as follows

	Underwriter	*% Share*	
1	Life Insurance Corporation of India	23 8	68 7%
2	Unit Trust of India	15 0	
3	I C I C I	12 2	
4	I F C	11 0	
5	I D B I	6 7	
6	S F Cs and State Industrial Dev Corpns	7 4	
7	Banks	2 0	
8	Brokers & investment and insurance companies	21·9	
		100	

The first five institutions accounted for more than two thirds (68 7%) underwriting business

The *Industrial Credit and Investment Corporation of India* is the most important single underwriting institution, because it caters largely for the needs of equity capital and because it makes underwriting of capital issues an important part (about 22%) of its financial activities as against those of I D B I (11%) and of I.F C (7%) only More than one fifth of its operations and over 40% of the investments relate to underwriting

The Life Insurance Corporation of India is a great potential underwriting institution, but its operations are greatly circumscribed by its investment policy which it has to fit into the framework of industrial investment under section 27 A of the Insurance Act Moreover, the emphasis is usually on *underwriting* of debentures and loans and of preference shares Underwriting of ordinary shares occupies a rather unimportant place Further, its under writing commitments are generally restricted to such issues and to such amounts as it may itself be prepared to hold as a permanent

or quasi-permanent investment In majority of cases the securities underwritten by it are subscribed by it without being offered to the public This, in fact, is not underwriting in the true sense of the word Still since 1964 65, it has emerged as the largest single underwriting institution

Although underwriting was one of the authorized businesses of *the Industrial Finance Corporation of India* under the provisions of the Act bringing it into existence, but no underwriting was done by it for almost ten years It has now entered the field, no doubt, but its underwriting operations form only a small proportion (7%) of financial assistance

Thus, it will be observed that in spite of recent growth and improvements, underwriting of capital issues in India has not yet developed into a well organized system It still remains in its infancy. One important drawback of Indian underwriting is that the available facilities are much less adequate for the issues of equity capital than for issues of preference shares and debentures The study of Mr M L Gupta referred to above showed that only 21 9% of the amount of equity capital offered for public subscription was underwritten as compared with 53 6% in the case of preference shares and 55 8% in the case of debentures The percentage of equity issues underwritten would have been even lower but for the fact that a large part of it is usually agreed to be subscribed privately by promoters, directors and friends, only the balance being offered for public subscription The far too inadequate facilities for the underwriting of equity issues hit the new companies more severely than the established ones, the latter being in a much better position to issue *senior* securities (i e , preference shares and debentures) than the former Even where an established company decides to issue further equity capital, this is very often taken up by the existing shareholders who have a preemptive right and the need to make public issue does not often arise This is the reason why the proportion of underwritten equity capital is much higher in the issues of new companies than in those of established ones, the percentage being 83 and 35, respectively

Secondly, it may be noted that very few of the institutions other than I C I C I are responsible for underwriting as much as 81 4% of the total amount of equity capital issued The commercial banks, it appears, would not touch it The only case where a bank had underwritten a very small equity issue was one where both the capital and the dividend had been guaranteed by a foreign company Insurance institutions (including the L I C) too show very little interest here No equity issue was underwritten by the stock brokers according to the study referred to above, except where they might have acted as sub-underwriters The I F C has recently entered into the underwriting of equity issues As regards investment trusts and finance companies, most of them are of a small size and their importance as underwriters is very little at present. The only one worth mentioning is the Investment Cor-

poration started by Tatas in 1939 which has interested itself in the underwriting of equity issues

A peculiar feature and a very great weakness of underwriting in India is that in most cases each underwriting agency acts in isolation from others in contrast to the system of working in syndicates in western countries The usual system in India is that a single underwriter generally takes up the entire issue without even the aid of sub-underwriters There have of course, been cases where two or more underwriters have joined hands in a single issue, but the number of such cases is rather small The absence of mutual co-operation among underwriters in India may be attributed to the absence till very recently of an institution which could command the confidence of other institutions and act as the leader of an underwriting group Recently however the situation seems to have changed for the better as the I C I C I, L I C and I.F.C have co-operated with each other in a number of cases in underwriting individual issues

The (Shroff) Committee on Finance for the Private Sector which reported in April 1954 had recommended the establishment of a consortium for underwriting purposes, comprising the leading commercial banks and insurance companies, under the leadership of the then Imperial Bank of India With the coming in of the I C I C I the idea of a consortium, it seems, was given up It is understood that the Reserve Bank did not look with favour upon this idea. The transfer of both the Imperial Bank and the life insurance companies to public ownership also led to the same result. It would appear there will be a considerable amount of collaboration and co-ordination among the various institutions in the field of underwriting under the leadership and guidance of the I.C.I C I, but still there is need of a formal consortium and the question should be re-considered in the light of the growing need and expanding capital market of the country In particular the banks should be encouraged to participate in the underwriting operations of I C I C I., with growing interest in the corporate securities, the expansion of the capital market and of the coming in the ideal of socialist society, the importance of ordinary small investor and consequently of a consortium[1] has increased all the more now The small investor of today needs the protection and guidance of an intermediary institution having specialized knowledge of investment practices.

Besides, the L I C and the I F C as the two leading financial institutions of the country should take more interest in under-

1 A move is afoot to form a consortium of credit financing institutions in the country to build up a sound capital market. This was disclosed by Mr G L. Mehta, Chairman of the I.C.I C I. at Bombay, towards the end of February 1962. A formal meeting was held some time ago at Bombay and the idea of a consortium had an overwhelming support. The consortium would be a fully representative body of all financial institutions in the country, including the L.I.C., the I.F C., commercial banks and other institutions in the field.

writing of shares and should liberalize their operations in this respect The I F C is a great potential institution, provided the Central Government allows it greater latitude and Parliament pays due regard to its autonomy Similar is the case with the L I C , its investment policy should be made more flexible under the provisions of the Insurance Act

At the same time the Government should also consider the question of promoting the development of investment trusts which form an important adjunct to the underwriting organization in England and America It would be necessary for this purpose to devise a tax policy which does not bear harshly on investment institutions There should also be special legislation governing the investment of funds by investment trusts so that they serve the national economy and not particular groups of industrialists Only those investments laid down in the special legislation should be granted special tax treatment

3. ***Legislative Protection to Investors*** The growth of investment habit and the capital market is largely conditioned by the statutory measures adopted to protect the investor The funds which pass through the capital market are placed in the hands of others by the investor either permanently (in the case of investment in shares) or for very long periods (in the case of investment in debentures or purchase of life insurance policies) It is of the utmost importance that there is fair amount of security for the funds so invested There is a fairly adequate legislative framework in India for the protection of the investor The measures consist of the following

(1) The Indian Companies Act, 1956

(2) The Securities Contracts (Regulation) Act, 1956

(3) The Insurance Act 1938 together with the Life Insurance Corporation Act of 1956

(4) The Employees' Provident Fund Act and Rules, 1952

(5) The Capital Issues (Control) Act, 1947

(6) The Banking Companies Act, 1949

Indian Companies Act, 1956 has made considerable changes in the procedure with regard to the issue of prospectus, allotment of shares, terms and conditions on which companies may be floated, and the capital structure of companies The particulars that a company is required to disclose in its prospectus have been considerably enlarged to place the investors in a much better position than they had been earlier to assess the intrinsic merit of a new issue The powers of managing agents have been considerably curtailed

The Securities Contracts (Regulation) Act, 1956 is the first all-India legislation which provides for a general apparatus for the control of dealings in securities It permits only those stock exchanges to function which are recognized by the Central Government All stock exchanges other than those recognized are declared illegal.

rities, local self governments, etc, get their securities easily listed, while a certain amount of discretion is exercised at the time of listing of industrial stocks and shares The stock exchanges ensure that the scrips of good projects alone are taken on the list and that the indifferent or bad propositions are left out Thus, they provide an extra safeguard to investors, in addition to the one got from the screening done by Government at the time of sanctioning capital issues to promoters under the Capital Issues Control Act and Licensing Regulations etc

Like the Company Law, the stock exchanges, in amorphous or organized form, have existed for nearly a hundred years, both having sprouted in the fifties of the last century There were seven stock exchanges in India on the eve of the second World War But the speculative prospects of war-time business led to the establishment of many more during the war period As a matter of fact, no less than six rival stock exchanges came to be established in Ahmedabad alone Five more were also established in Lahore, one in Delhi, one in Kanpur and one in Nagpur By 1945, the number of stock exchanges in India came to 21, exclusive of unorganized ones, Katni market, etc Too many stock exchanges and diversity of rules and regulations among them relating to membership and trading, and the post-war crash of 1946 all combined together to compel the Government to enact the Securities Contracts (Regulation) Act in 1956 Under this Act, only seven stock exchanges have been granted licence to operate in this country They are the stock exchanges at Calcutta, Bombay, Madras, Delhi, Hyderabad, Indore and Ahmedabad

A total of nearly 2,200 Government securities and scrips, accounting for a total value of over Rs 2,500 crores, are quoted on the seven stock exchanges of the country The total number of Central and Provincial Securities, loans and debentures floated by certain Port Trust authorities and Municipal Corporations, State Electricity Boards and State Transport authorities is 195, accounting for a total nominal value of Rs 1,800 crores The number of industrial scrips is about 2,000 including scrips of a few foreign companies, the value of the scrips of Indian companies being Rs 695 crores issued by 1150 joint-stock companies Thus, a total of 4,400 shares and securities of the total value of about Rs 5,000 crores are dealt with on the seven recognized stock exchanges Of the industrial securities 61% are ordinary shares, 31% preference shares and 8% debentures Cotton, tea, jute, engineering including iron and steel, banking and insurance, coal mining, sugar, electricity, etc, are the industries which are popular on the stock exchanges

Reform of Stock Exchanges Before the Securities Contracts (Regulation) Act was passed in 1956, there was no Central Act to regulate the working of stock exchanges on a national plane and to prescribe uniform rules and regulations They functioned as 'private clubs' governed by the sets of rules and regulations framed by a small group of persons—the members of the stock exchanges concerned

Different rules prevailed in different stock exchanges and the Government had no effective reserve powers to intervene in time of hectic speculative activity as was noticed in 1937, 1946 or 1955 The present Act has brought the stock exchanges under the surveillance of the Central Government

Under the provisions of the Act, no stock exchange can operate in the country, unless it has obtained a licence from the Central Government All stock exchanges are now required to have their rules and regulations approved by the Central Government Uniformity of practices in this regard is now being sought to be achieved by the Government

The Central Government has also the power of calling periodical returns, of inquiring into the affairs of a stock exchange, of withdrawing the recognition or of superseding the governing body of a stock exchange Under the Act no person other than a member of a recognized stock exchange can deal in securities in a notified area Option dealings in securities have been prohibited All transactions (other than those specified for settlement through a clearing house) should be on 'spot delivery contract' basis Only individuals can now become members of stock exchanges All members are now required to put in a security deposit They are also required to keep and maintain a prescribed set of books of accounts

In spite of strict regulations imposed by the Act, it is wrong to suppose that there is no further scope for the reform of stock exchanges

It is estimated that out of 7,300 public companies at work in the country, only 16% enjoy the privilege of their shares being quoted on the stock exchanges That is to say, in our country, the shares of only one out of six joint stock public companies are listed on one or more of the seven national stock exchanges Secondly, the Government companies in the corporate sector do not have any of their shares quoted on the stock exchanges Thirdly, a great majority of the companies quoted on the stock exchanges belong to the higher strata and only a small number of the smaller size companies has made its way into the stock exchange lists Fourthly, the data relating to the working of stock exchanges are very scanty and as such no study of the extent of speculative activities is possible before a crisis develops and affects the fortunes of genuine investors and jeopardizes the economic development of the country To give just an instance, today, we have no information relating to the volume of the cash and forward transactions total turnover on the stock markets, volume of transactions carried over, squared up and actually delivered with which we could gauge the imbalances appearing on the markets The exact scope of the missing data and the feasibility of their collection will have to be looked into carefully in the context of the Securities Contracts (Regulation) Act and the by laws of the Stock Exchange Regulations approved by the Government

A review of recent trends in the Capital Market

The Indian Capital Market displayed a state of buoyancy during the years of the second World War and a few years thereafter (till 1950), but it suffered a set back in subsequent years The situation turned for the better in January 1958 and displayed a rising tendency on account of rising tempo of economic development The buoyancy in the share market noticed since January 1958 and the easy conditions were, however, of a short duration and lasted till the end of 1962 As a sequel to the declaration of the emergency in October 1962 there was slackness following *the landslide in the share markets* The transition of the market from a state of bullishness to one of bearishness was brought about mainly by apprehensions of heavy taxation to meet the mounting costs of defence following the Chinese aggression and by the bears of the possible effects of such heavy taxation on industrial growth and corporate earnings The depressed state of the capital market initially developed in the wake of the Emergency and the severe measure of the 1962-63 and subsequent budgets has continued to be extremely depressed and has tended to wilt further in the face of successive blows to investment confidence, viz, the combined influence of monetary, fiscal and political factors The result is that even prosperous and well manged companies find it extremely difficult to raise fresh capital, particularly in the form of risk capital, from the open market

The Reserve Bank's weekly All-India index of Variable Dividend Industrial Securities (base 1952-53=100), after advancing to an all-time peak of 195 6 during middle of May 1962, stood at 188 0 during the last week of August and early September Thereafter the index began to decline and registered *a precipitate fall* to 168 7 towards the second week of November 1962 A landslide in share values took place on November 5, on heavy selling pressure, necessitating the temporary closure of two of the stock exchanges, Bombay and Ahmedabad After brief spells of steadiness, the index again went down sharply and touched 160 3 by the end of March 1963 showing a decline of 35 3 points in about ten months With a slight recovery during the year 1963 64, the index again fell further to 157 8 in March 1965 and has continued to decline further

The gilt edged market was in a process of adjustment to the higher yields offered on the new Central and State loans issued in July and August 1962 and 1965 and the upward revision of the Bank rate in January 1963, September 1964 and February 1965 In this process of adjustment the prices tended to decline, the Reserve Bank's All-India Index of Government of India Securities (base 1952-53=100) declining to 98 7 by the end of March 1963 and to 97 9 by March 1965 During the period almost all the loans registered net declines

The reasons for the sluggish state of affairs in the capital market are partly political and partly economic High in the list stand the

political ones the Chinese menace, Pakistan's bellicose attitude and nacked aggression in August 1965 and the gradual disintegration of the Congress Party as evidenced by group rivalry in most of the States The *economic causes* are many and varied

(1) To some extent the depressed state of the stock exchanges is a sequel to a *long period of boom* A boom has to end at some time or the other, it cannot last for ever The boom starting in January 1958 came to an end towards the close of 1962 decisively at the hands of the Chinese Communists This could not be helped But a lesson can be learned that care should be taken to see that another boom of that type does not emerge again. The aim should be a steady appreciation in equity values that can be sustained by the performance of corporate sector through fiscal incentives and appropriate adjustments in economic policies of the Government.

(2) The pace of *industrial progress has suffered a distinct setback* for more than one reason (a) shortage of foreign exchange and the consequent restrictions on maintenance imports, (b) imposition in February 1965 of an additional 10% import duty, (c) scarcity of power, fuel and transport and to some extent, even finance, and (d) diversion of real resources to defence The result of all this is a setback to the rate of national savings

(3) Besides, *the profit-margins of almost all industries have been adversely affected* by high cost of raw materials and wages, heavy incidence of excise duties not all of which could be passed on to the consumers, exports at losses, fixation of unremunerative prices payable to manufacturers where there are controls, and, above all, the increase in the burden of direct taxation The reduction in net profits of companies have meant a reduction in dividends disillusioning many an investor who had bought equities at high prices in the expectation of an increase in dividends

(4) *The high corporate taxes and their rising trend* in recent years is also an important reason leading to low capital formation in India The proportion of corporate taxes to total profits in India varies between 51 to 53% as against 32 to 34% in U K., 42 to 44% in U S A. and 38 to 42% in Japan The high tax burden on companies is responsible for downward trend of retained profits which adversely affects growth of corporate sector

(5) The decline in the new issues activity is partly attributed to the stagnant level of national savings during the period of the Third Five Year Plan

(6) *The ideological predilections of the Government* have also resulted in wastage of capital and the formation of high cost industrial units One has particularly in mind the policies designed (a) to reserve certain spheres for the public sector, (b) to check monopolies as well as concentration of economic power, and (c) to encourage large-scale industrial co-operatives These policies have retarded the country's economic progress and thereby the rate of capital formation.

(7) There was a sizable amount *of fooling of investors by company promoters* who manipulated to quote at fantastic premiums the shares of new companies even before they were listed in the markets, largely as a result of artificial deals in them and presentation of a rosy picture of the prospects of their companies, difficulties were underrated and the possible advantages of foreign collaboration were exaggerated They attracted to stock exchanges a lot of people who wanted to get rich overnight Many sold their investments in other assets and bought shares Others entered with borrowed capital As the shares of existing companies went up sky-high, those of new companies were keenly sought after on the theory of entering the house through the basement This appetite was whetted by the manipulations of a large number of company promoters The artificial boom conditions attracted stages of varying calibre and strength When it burst, they got scared and ran away leaving the investor in a helpless position

(8) Not all the *company promoters* deliberately misled investors They *have themselves been badly let down by the public sector* in regard to the provision of power and transport facilities, in sanctioning licences for the import of plant and machinery and in fulfilling the various promises held out at the time the projects were mooted In the last mentioned respect, some of the State Governments in particular are to be blamed Further, the difficulty in getting land for putting up industries has been accentuated by the invalidation of the land requisitioning powers of State Governments by the courts of law Many engineering units have not received the basic steel products they had been promised by the public sector plants The net effect of these developments is disappointment to investors, including the L I C as the fulfilment of their expectations has been delayed

(9) *Chinese incursion and continued threats and Pakistani aggression* have considerably aggravated the situation As a result of needs of defence and development, the Government's requirements of funds suddenly spurted up and the Central Government's budgets of 1963 64 and 1964-65 were much more harsh than was generally expected There was *an alround increase in taxation*

(10) *The policy of credit squeeze and increased bank rate in quick succession* have added fuel to the fire The Bank Rate has been raised 5 times since planning started from 3% to 6% and 3 times since 1963 (January 1963, November 1964 and February 1965) In the summer of 1965, the Reserve Bank issued a directive to commercial banks to reduce their advances by 200 crores and invest the money so saved in Government bills The policy announcement early in 1966 by the Reserve Bank has increased the cost of advances to commercial banks in all sectors and the result is further scarcity of loan capital of commercial banks The financial institutions like I C I C I and I F C have also stiffened the conditions of loan and increased interest rates

(11) *The bearish trend was further accentuated* by (i) the growing

international tension arising from the developments in the Vietnam situation, (ii) fears of stringent Governmental measures to hold the price line and of further cuts in imports of raw materials, (iii) a shift in planning on account of Chinese and Pakistani aggression to a war-time footing, (iv) the issue by the Reserve Bank on October 31, 1962 of a directive imposing for the first time a limit on the total amount borrowed by a bank from it for normal purposes and its exhortation to bankers recalling certain types of advances including those against shares, (v) fears of fresh taxation, (vi) acute food scarcity brought about by unprecedented drought of 1965 and 1966 joined hands with an extremely tight foreign exchange situation, (vii) the provision to restrict the period of currency of blank transfers contained in the Companies Amendment Act, 1965, (viii) imposition of $7\frac{1}{2}\%$ dividend tax on equity dividend and $12\frac{1}{2}\%$ bonus tax, etc.

Among *the regulatory measures* undertaken *by the stock exchanges* of the country in order to check the excessive speculative activity and the depressed state of the markets, mention may be made of (i) the intensification of the uniform automatic margin system which had been in force on all stock exchanges since December 1961, (ii) the reintroduction of special deposit making-up prices, (iii) a new system of margins under which members had to deposit fixed amounts on fresh sales, (iv) the curbing of jobbing business or its total stoppage, (v) the fixation of minimum prices for securities, (vi) the introduction of compulsory carry-over, and (vii) the reduction in trading hours.

The series of measures undertaken *by the Government* to revive the capital market and to stimulate capital formation include: (i) the grant of a loan of Rs. 10 crores each to the Industrial Finance Corporation of India and the Industrial Credit and Investment Corporation of India during the last years of the Third Plan in order to enable them to underwrite and support new public issues, (ii) the setting up of the Unit Trust of India (Feb. 1964) to mobilize savings in order to complete the large investment programme before the country, (iii) the establishment of the Industrial Development Bank of India (July 1964), (iv) the pursuit of a vigorous policy by the State Bank of India to help small-scale industries, (v) the readiness of the I.D.B.I. to help the banking system to provide medium-term loans to industry, (vi) the adoption by the Reserve Bank of India of a more positive credit policy to meet the demands for productive purposes, (vii) granting of permission to the recognized stock exchanges to resume forward trading under certain conditions (June 1963) and allow some relaxation in the system of margins (July 1964) and the adoption of a more flexible and liberal policy in regard to the control over capital issues, (viii) raising of the exemption limit in respect of industrial licensing as well as capital issues from Rs. 10 lakhs to Rs. 25 lakhs, and (ix) the assurance by the Government that approved private sector projects, which were ready for implementation, were not held back for want of rupee finance, (x) giving to individuals a number of fiscal reliefs designed to induce a greater flow of personal savings, (xi) announcement of

selective tax concessions to a wide range of industries during 1964-65 with a view to stimulate production and exports and to encourage their expansion and development, (xii) announcement in December 1964 of an incentive scheme for investment in equity shares of new industrial companies in the form of tax-free tax credit certificates, (xiii) exemption since March 1964 from the wealth tax for a period of 5 years the investments in equities of industrial companies issued for the first time, (xiv) enhancement of development rebate in respect of *new plant and machinery installed after March 31, 1965,* by specified industries from 25% to 35%, (xv) relaxation of (11 industries, in May 1966) industrial licensing procedures relating to expansion and diversification of production as well as for the establishment of new units, (xvi) the abolition of bonus tax, reduction in the company sur tax from 40% to 35% and exemption of companies from 7.5% dividend tax in respect of their distribution up to 10% of paid-up equity capital in 1966 67

The National Council of Applied Economic Research suggests certain measures[1] in order to revive and correct the sluggishness of the Indian capital market (1) Since unaccounted money—a large volume (about Rs 1200 crores) of which exists in the country—can easily flow into several forms, like gold, land, buildings, commodity stocks etc, while it has to be rigorously accounted for if it comes in the form of industrial shares, the former must be made relatively unattractive by enforcing stricter controls and imposing additional tax burden on such forms *Secondly, steps should be taken to make* industrial securities attractive (2) A new company pays the basic corporate tax of 55% and intercorporate dividend tax of 25% This double taxation produces a heavy aggregate burden on intercorporate investments and discourages the existing companies to diversify their industrial activities by starting new ventures There should be the reduction of the overall burden of these taxes A reduction in these taxes would not reduce the total revenue to the Govt since lowering of the tax burden should help promote wider industrialization and taxation base which can compensate any loss of revenue *(3) Just as the income from Government securities and* the Unit Trust of India is treated as earned income, dividend income should also similarly be treated as an earned income in order to provide an incentive to the shareholders (4) Permission should be granted to invest partly the Provident Funds in industrial securities (5) In order to tap the savings of individuals with moderate means, more unit trusts should be set up and private enterprises encouraged to enter this field The unit trusts that come up in the private sector will help create a healthy competition among various trusts for they *will extend their area of operation to reach all potential investors (6) A good deal is possible by a joint responsibility of all the partici*pants in the capital market—the companies the stock brokers and the stock exchanges—to ensure that adequate information is given and publicity done to keep the individual investor well informed

[1] NCAER—Capital Market in a Planned Economy 1966 pp 71-73

by any company other than a banking or an insurance company or a provident society incorporated as a company are exempted from the provisions of the Act The exemption limit does not apply to the issue of bonus shares by capitalization of reserves or share premium, for which Government permission under the Act is still necessary irrespective of the amount of issue involved

Trends in capital issues

Joint-stock companies at work

Year	*Number*	*Paid-up capital (Rupees in crores)*
1950–51	28,532	775
1955–56	29,874	1,024
1960–61	26,149	1,819
1961–62	24,975	2,019
1962–63	22,622	2,256
1963–64	26,002	2,460
1964–65	26,653	2,636
1965–66	27,141	2,875

It is noted from the amount of paid-up capital of joint-stock companies during recent years that there has been a continuous rise in the amount of capital raised by the companies in spite of the control The total paid-up capital of all joint-stock companies at work in India was Rs 775 crores in 1950-51, i e., in the beginning of the First Five Year Plan It rose to Rs 1,024 crores by the end of the Plan, showing an increase of Rs 249 crores over the five years or about Rs 50 crores per year During the period of the Second Five Year Plan, there was greater rise, the total amount going up to Rs 1819 crores by the end of the plan, i e , an enhancement of Rs 795 crores or Rs 159 crores per annum In the five years of the Third Plan the increase was by Rs 1056 crore or Rs. 211 crores per annum This increase since 1956 was in spite of the fact that there was a substantial reduction in the number of companies at work between 1956 and 1963 as a result of the process of elimination of moribund and inactive companies from the register of live companies by the *Company Law Administration*

Separate data for non-Government companies are available only from the year 1956 The data indicate a continuous growth of the private corporate sector , the increase in paid-up capital of non-Government companies was Rs 314 crores during the Second Plan period and a further Rs 297 crores was added in the first four years of the Third Plan There was thus an average annual increase

of Rs 68 crores since the beginning of the Second Plan. The total paid-up capital of non-Government companies at Rs 1,569 crores at the end of March 1965 constituted about 60% of the total paid-up capital of both Government and non Government companies (Rs 2,636 crores). As between public and private limited companies in the private sector, the former accounted for about three-fourths of the total paid-up capital of non Government companies, although in numerical strength they constituted less than one-fourth of the total number of non Government companies.

Paid-up capital of Government and non-Government companies

(Rupees in crores)

Year	*Govt Companies*	*Non-Govt Companies*	*Total*
1955–56	66	958	1024
1956–57	73	1005	1078
1957–58	257	1049	1306
1958–59	429	1087	1516
1959–60	477	1142	1619
1960–61	547	1272	1819
1961–62	629	1389	2019
1962–63	786	1470	2256
1963–64	960	1499	2460
1964–65	1067	1569	2636

New issue activity has been growing since 1951 consistently with the growth of the corporate sector. Although there have been fluctuations from year to year, the magnitude of new issues has increased from less than Rs 5 crores in 1952 to Rs 61 crores in 1960. This rising trend in new issue activity continued in subsequent years and the magnitude of new issues rose steeply to Rs. 98 crores by 1962 (including debenture issue of Rs 30 crores by Oil India Ltd—an undertaking jointly owned by the Central Government and a private sector company). There was, however, a sharp set-back during 1963-64 as a sequel to the declaration of the Emergency in October 1962 as a result of which the amount of new issues declined to Rs 54 crores but even then this figure was higher than in any year prior to 1960. There was substantial increase during 1964-65, the amount having gone up to Rs 80 crores.

Issues of fresh capital

(Rupees in crores)

Year	Ordinary shares	Preference shares	Debentures	Total
1951	4 3	1 3	2 3	7 9
1952	2 9	0 4	1 4	4 7
1953	7 2	0 4	4 9	12 5
1954	20 4	2 4	10 4	33 2
1955	16 3	4 4	5 5	26 2
1956	33 1	10 5	1 6	45 1
1957	19 1	2 0	3 7	24 8
1958	17 5	3 1	5 3	25 9
1959	28 9	9 7	4 6	43 2
1960	52 0	5 3	4 1	61 3
1961	58 9	4 5	1 1	64 5
1962	63 2	2 6	38 0*	103 8*
1963	47 8	3 0	3 0	53 8
1964	64 8	4 2	11 0	80 0
1965	67 76	9 85	21 12	98 72

Note —The data relate to non Government public limited companies

The period 1959 to 1962 (until the declaration of the Emergency in October 1962) was a boom phase for capital issues as the investment climate remained favourable as a result of the growth prospects of industries in an era of planned development and prospects of capital appreciation in the context of the continued bullish trend in stock markets The Reserve Bank's index of variable dividend industrial securities rose by 30% in the two years 1958 and 1959 and by another 24% between 1960 and mid 1962, the total rise in the boom phase in the stock markets, lasting about 4½ years from January 1958 to June 1962, being of the order of 60% The rising trend of capital issues over the years would also suggest the growth of investible funds combined with the growing investment interest among the new middle class investors The magnitude of new issues which had increased from Rs 26 crores in 1958 to Rs 43 crores in 1959, rose to Rs 61 crores in 1960, Rs 65 crores in 1961 and further Rs 98 crores in 1962 The appreciable rise in equity issue from Rs 17 crores in 1958 to Rs 68 crores in 1965 would indicate the growing popularity of equities among investors and their willingness to provide risk capital to industry in the context of the prevailing favourable capital market conditions

* Including debenture issue for Rs 30 crores by Oil India Ltd

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Medium-term Finance in India

As already stated medium-term finance is one which is needed by industrial units for periods ranging for one to five years, though the committee on State Industrial Finance Corporation in West Bengal (1951) regarded it from one to ten years and the Shroff Committee (1954) endorsed this view. The *Refinance Corporation* for Industry, the specialized institution of medium-term finance in India formed in 1958, used to grant loans to eligible institutions for periods between 3 and 7 years and extend the period to 10 years in special cases. *The practice of European countries in general* is to regard medium-term finance for periods ranging from one to five years. Thus, there cannot be any rigidity about it. The period of medium-term finance may vary from country to country, from industry to industry and from unit to unit. One to seven or even ten years, however, seems to be more nearer practical considerations.

Medium-term finance is usually required by industry for purposes of extensions and replacements. It is also sometimes needed for installation of machinery and equipment or for rationalization purposes. The need for such finance in India has increased tremendously in the post-war period. The industry was strained to the hilt during the war years, but the work of renewals and replacements could not be carried on on account of the difficulty of importing necessary parts and equipment. The work of renewals and replacements, thus, went on accumulating from year to year and has assumed large proportions in recent years. With an emphasis on industrialization in successive Five Year Plans, the demand for such finance has increased tremendously and is increasing day by day. The decline of the princely states and the abolition of the Zamindari system have further aggravated the problem. The supply of capital is adequate for the normal needs of the economy but not adequate for abnormal demands of wide magnitude.

Sources of medium-term finance

Broadly speaking, the sources of medium-term finance may be grouped into two classes: (a) *Internal finance* and (b) *External finance*

The former relates to the ploughing back of industrial profits and the latter is supplied by outside agencies

Internal Finance Though internal finance through ploughing back of profit is by far the most important source of finance for the expansion of fixed assets, it is not always adequate in all cases The newly established industries and medium-sized concerns generally have to encounter great hardships in the matter of such finance either for expansion or for rehabilitation The day to day inflation resulting in higher and ever higher costs of working the ever rising wages paid to labour under threats of strikes, the growing pressure of taxation and other similar developments have considerably curtailed the savings of Indian industries in recent years Thus, internal finance proves inadequate for the growing needs of Indian industries

External Finance The external sources of medium-term finance are

(1) Issue in the capital market of shares and debentures,

(2) Public and private deposits,

(3) Government credit,

(4) Loans from non banking sources, (i e the Industrial Finance Corporation, State Finance Corporations Industrial Credit and Investment Corporation, Industrial Development Bank of India, Unit Trust of India, etc),

(5) Loans from the banking system

Shares and debentures—Market trends show that, while capital is rather shy in regard to new issues, it is available for issues of existing concerns for purposes of extensions and expansions Shares and debentures, however, are not a very popular method of financing small and medium sized industrial concerns Only large concerns resort to this method of finance

Public and private deposits—What has been said above about shares and debentures is also true about deposits Deposits are a source of limited utility and are available to a limited class of large industries

Government credit—Governments both at the Centre and in the States have taken steps to enlarge financial facilities at present available to industry These facilities, however, are generally by way of occasional relief usually to small-scale industries and not of general nature so as to benefit all industries requiring finance The amount of finance made available is also in the form of very small loans It is not much of an industrial value for effectively fostering production Moreover, the intention seems to be gradually to replace it in a planned manner by institutional credit

Institutional credit—The Industrial Finance Corporation and Industrial Credit and Investment Corporation cater to the long-term needs of large-scale industries generally They hardly provide

medium-term finance. The National Industrial Development Corporation is meant to promote and develop new industries and does not render financial assistance for expansion purposes A limited service is rendered in the matter of medium-term finance by the State Finance Corporations in general and the Small Industries Corporation in a limited field When these financial institutions were founded, the vision of the country's industrialization was somewhat narrow in the eyes of the Government Hence they were set up with certain definite objectives to serve different needs of our industry. But during the First and Second Plan periods, progress *in the industrial field had been considerable It was therefore felt* that a new institution was needed to cater to the medium-term financial requirements of industry There was an urgent need for an institution which would serve the purposes that were being served in other countries by discount houses providing finance for those new industries which would not attract equity capital immediately but which could attract equity capital when they went into production. The institution was intended to provide medium-term credit to an industry and keep credit going for such time as the particular industry went into production Once the production side was in its stride, the industry concerned could go to the equity market and call for subscriptions or to the debenture market. Consequently, the Refinance Corporation for Industry was started as an institution specializing in medium-term finance.

The Refinance Corporation for Industry Private Ltd. (R.C.I.)

Origin—One of the terms of the Agricultural Commodities *Agreement under P.L. 480 signed between the Governments* of India and the U.S.A., in August 1956 provided that rupee equivalent of 55 million dollars (about Rs. 26 crores) of 'the counterpart funds created out of sale proceeds of American wheat, etc., should be set apart for relending to private enterprise in India through established banking channels. Ultimately, however, it was decided to channel these funds through a separate corporation, and this resulted in the creation of the Refinance Corporation for Industry Private Ltd., registered on June 5, 1958, as a private limited company under the Indian Companies Act, 1956. After the amendment in the Indian Companies Act in 1960, the Corporation became a Public Company as its entire share capital was held by corporate bodies.

Object—Though the immediate objective *in setting up the* Corporation was the disbursement of counterpart funds, its ultimate goal was to bridge the gap that existed in the institutional arrangements available for financing medium-sized industrial units, in regard to their medium-term requirements, such as, installation of machinery and equipment, etc. The Corporation thus augmented the resources available for the use of medium-sized industrial units in the private sector by providing refinancing facilities to its member banks and State Financial Corporations against medium-term loans granted by them to concerns belonging to this category.

Though the progress of the activities of the R.C.I. in the early years of its existence was slow, yet since 1960 it widened its area of operations considerably and rendered useful service to industry of the country. As many as 58 banks, 15 State Financial Corporations and 4 State Co-operative Banks availed of the refinancing facilities provided by the Corporation. But developments during the Third Five Year Plan led to the establishment of a larger institution of industrial finance viz. the Industrial Development Bank of India in July 1964. According to a provision made in the Act constituting the I.D.B.I., the business of the Refinance Corporation was taken over by the I.D.B.I. since September 1964 and by July 1965 the Corporation was finally dissolved. Now all business of refinancing of industry has come under the jurisdiction of the I.D.B.I., which is the only institution of large-scale medium-term finance in the country.

Industrial Development Bank of India (I.D.B.I.)

The Industrial Development Bank of India was established in July 1964 under an Act of Parliament passed in May 1964. It was set up as part of a reorganized and integrated structure of industrial financing institutions in the country geared to the needs of rapid industrialization. The main object was to bring into existence an apex institution to co-ordinate the activities of other financial institutions, including banks. The role of the I.D.B.I., among other things, has been conceived as one of enlarging the usefulness of the existing financial institutions by supplementing their resources and widening the scope of their activities.

Thus, the major business of the I.D.B.I. is to provide assistance to other financial institutions. Assistance to other financial institutions covers such activities as refinancing of loans given by other eligible institutions (specified in the Act or notified by the Central Government) and subscribing to their shares and bonds as well as guaranteeing their underwriting obligations in connection with the share and bond issues of industrial concerns. The eligible institutions taking advantage of the refinancing facilities of the I.D.B.I. include 59 scheduled banks, 15 State Finance Corporations, 8 State Co-operative Banks and the Industrial Finance Corporation of India and the Industrial Credit and Investment Corporation of India.

Loans to be eligible for refinance should be repayable between 3 and 25 years in the case of I.F.C., S.F.Cs. and I.C.I.C.I., and between 3 and 10 years in the case of Scheduled and State Co-operative Banks. Besides, export credits granted by any of the above mentioned institutions for periods between 6 months and 10 years are eligible for refinance. Thus, the I.D.B.I. has been empowered to provide refinance to a larger number of financial institutions and for longer periods than the Refinance Corporation for Industry used to do. Besides, there are no restrictions on making refinance available against loans in terms of size of concern or size of loan. The I.D.B.I. now operates all the three schemes which

R.C I worked, viz., (i) Scheme for refinancing of industrial loans, (ii) *Scheme for refinancing of export credits, and* (iii) *the* Government of India's scheme for guarantee of advances made by specified financial institutions to the coal industry in the private sector

Since the inception of R C I in June 1958, up to end of June 1966, 1,020 *applications for a demand at Rs 162 crores were received* from financial institutions for refinancing of industrial loans, of which 704 applications valued of Rs 105 9 crores were sanctioned and the refinance actually disbursed was Rs 82 crores, while the amount outstanding was Rs 63 4 crores The amount of Rs 105 9 crores sanctioned was shared by different institutions as follows

Institutionwise industrial loans refinanced
(1958 66)

	Institutions	Amount sanctioned Rs cr	%	Amount disbursed Rs cr	%	Amount outstanding Rs cr.	%
1	Commercial Banks	84 6	79 9	64 2	78 3	48 5	76 5
2	State Co-op Banks	5 0	4 7	4 6	5 5	3 6	5 7
3	State Finance Corps	16 3	15 4	13 2	16 2	11 3	17 8
	Total	105 9	100	82 0	100	63 4	100

It may be noted that 80% of the finance sanctioned was to commercial Banks, 15% to S F Cs and 5% to State Co-op Banks

Role of banks

Loans from the banking system hitherto have generally been for working capital as Indian banks, like their British counterparts, refrain from engaging in financing the medium-term and long term (block capital) needs of industry Term lending by banks has not been popular *in this country, owing to the weight of British* traditions in Indian banking With the ratio of advances to deposits well over 70% and in individual cases topping even the 80% mark it is but natural that the Commercial Banks now lack the credit base to carry the load of medium-term finance to industry Of the total deposits, those that are repayable on demand constitute 60% and those repayable within three to six months some 30%, while deposits which have a year to run represent a bare 10% The experience of industrial banking in this country has also not been happy as was evidenced by the several failures of industrial banks set up in the pre-World War I period as well as in the inter-war period However, there is reason to believe that the Indian banks, like their counterparts abroad, *follow the practice of rolling over a substantial part of their advances* That is to say, while most of *the credit is formally made on a demand basis, a fair* portion of this 'demand' credit is in effect allowed to run for considerable periods either through not being recalled, or if recalled, through immediate or early renewal These advances, though technically

returnable at short notice, are virtually medium term loans This, however, is simply a make-shift arrangement The baffling question that is being discussed by banking experts in his country and elsewhere for several decades now is whether it is possible and desirable to give legal recognition to this practice so as to make the problem of industrial finance somewhat easier than it has been so far This question of Indian banks extending their activities into the sphere of medium-term, if not long term, financing of industry has been discussed at various stages in the course of evolution of the banking system The Central Banking Enquiry Committee considered the question in great detail over three decades ago The majority of its members recommended against Indian banks undertaking term financing of industry The Shroff Committee in 1954 also did not favour the idea of pressing commercial banks to provide term finance to industry It, however, recommended an indirect participation by banks in medium and long-term industrial finance The International Monetary Fund Mission which visited this country in 1953 also made a similar recommendation The conditions, however, changed substantially thereafter and provided an occasion for the re-examination of the question The industrial bias given to the Second Five Year Plan and the urgent and massive demand for industrial capital, the slow expansion of the public capital markets and the general inflationary state of the national economy are the factors which have pressed the country to justify the very substantial provision of industrial finance by the banking system on medium and long-term basis It is pointed out that, on the one hand, the proportion of time deposits to demand deposits is rising in the post-war years, particularly since 1955, and on the other hand, there has come about a revolutionary change in the outlook regarding bank deposits The deposits are now considered less subject to mass withdrawal than they were in the nineteen thirties Further, it is argued that in bank lending no clear line can be drawn between provision of credit and provision of capital and in practice banks have in many cases been providing medium term finance in the guise of short-term advances by renewal and re-renewal method.

Practice in European countries

These questions have been discussed in detail on the basis of factual data collected by the European Productivity Agency of the Organization for European Economic Co-operation in a Report entitled 'The Supply of Capital Funds for Industrial Development in Europe' published in January 1957 The Report is based on the findings of the Agency which studied conditions in the European capital market in the years 1952, 1953 and 1954 The Report states that significant results have been achieved by setting up specialized institutions for long term lending to industry from resources provided by the commercial banks, and it would be no over-statement to say that the banking systems are fairly generally expected to do more for financing the capital formation of industry

than orthodox views on deposit banking would allow It adds that it might be advisable to concentrate on devising newer techniques for solving the problems involved than to go on fighting a rear-guard action against trends of developments The report reveals that banks in Europe are found breaking new ground in the field of industrial finance It shows that the banks, without abandoning their traditional role as suppliers of short-term credit, are not unwilling to shoulder the responsibility for slightly long term credit What is perhaps less well known is that the ordinary commercial banks themselves do not view with disfavour a slight departure into the realm of medium-term financing The Report argues that one of the commercial banks' essential functions is to supplement their customers' working capital by lending them the additional funds needed for financing stocks, work in-progress, debtor accounts and exports until the proceeds of sales are collected Since stocks and work-in-progress are elements in capital formation, it is clear that banks do *in practice provide their customers with capital year after* year, and in spite of the conventional views on the short-term character of bank credit throughout the normal life of industrial firms, much of their working capital is their bankers' money

Two important factors have influenced the European banks in their decision to undertake medium-term financing The one is the higher ratio of time deposits to total deposits in many countries than it formerly was, a considerable amount of institutional money and enhanced business reserves are left with the banks for fixed periods of up to two or three years and even longer the concern of Governments about depositors' interest and the measures taken in the recent past to protect them, has also led many people to expect that the authorities will act without delay if an emergency comes and that their action will be effective [1] The second factor is the belief of banks about a hard core of the deposits which is unlikely to be drawn upon In this connection the Report observes "It is probable, though hard to prove statistically, that, for psychological as well as structural reasons, there is a hard core of bank deposits which is not likely to be severely affected by a sudden rush into liquidity " Relying on this assumption and also on their own resources in capital and reserves, and on the extensive facilities for *mobilizing* assets through the central banks, some commercial banks seem to consider as justified the use of part of their deposits for long-term loans to industry

The report describes the changes in banking practice which have taken place in different European countries in recent years So far as the U K is concerned, it notes that liquidity has always been their leading feature In daily practice, however, there are exceptions to text-book principles Moreover, the banks provide long-term capital resources by means of their contribution to spe-

[1] In India in the recent failure of the Palai Bank, the Government of India *has protected depositors up to Rs 250*

cialized credit institutions such as the Industrial and Commercial Finance Corporation In spite of statutory restrictions, many of the French banks do not limit their transactions to short-term lending and many of them exercise a considerable influence on the management of the firms financed by them The *French Banques de' affairs* have traditionally specialized in providing long-term finance either by acquiring shares in industrial and commercial companies and ultimately selling these shares to the public, or by preparing and underwriting issues of debentures by such companies In Germany, early after the currency reform of 1948 when many of West Germany's mills and factories were 'little more than heaps of ruins', the banks had to provide extensive medium term credit for the restoration of industrial buildings and equipment Neither official control nor their lending policy has prevented the deposit banks in Sweden from making rather long-term loans to Industrial units This is more or less true of Austria also where there has been a tradition of close association between banks and industry Austrian banks take an active part in issues or securities on capital market All applications for admission of new issues to the stock exchanges have to be submitted through a bank which is usually required by the Stock Exchange Board to take up 5% to 10% of every issue in order to ensure normal trading conditions for the securities issued In Belgium, however the contribution of commercial banks to the provision of medium and long-term finance to industry is strictly limited, although for nearly 50 years up to 1940 that country's industrial expansion was mainly financed by the banks In Italy, too, the position is virtually the same

India's need

In India also similar views have prevailed in recent years and a strong plea has been made urging Indian banks to provide medium-term finance to industry under the changed circumstances of the present time Dr B K Madan, Principal Economic Advisor, Reserve Bank of India, in the course of an article entitled 'Banks and Medium-term Credit to Industry' published in the June 1957 issue of the Reserve Bank of India Bulletin expressed the view that commercial banks in India constituted suitable institutional system for providing medium term finance for industry, provided certain safeguards were taken That there is need for medium term finance from the banking system, though provision of such finance by banks has not been popular in this country, as in the U K , is evidenced by the common practice among banks of 'rolling over a substantial part of their advances , or in other words, of allowing a substantial part of the advances formally made on demand basis to run for considerable periods According to Dr Madan, such medium-term finance is likely to increase the inflationary pressures in the economy He, therefore, suggests two counter measures in order to check the evil effects of inflation Firstly, the availability of bank finance should be restricted so as to avoid over-expansion of credit for speculative purposes and

secondly such finance should be adequate to meet the needs especially of new industries only There are certain types of credit situations in which commercial banks should be able to play a helpful role On the one hand there is the case of large first class established concerns with a good record which may require funds for *replacement, modernization or minor expansion of machinery and equipment* where the profitability and repaying capacity of the borrowing industry does not raise difficult technical problems This will be particularly so where a bank is already meeting the working capital requirements of an industry and especially if it is extending credit on a scale and with the facility of renewal which enables the borrowing industry in effect to utilize the funds for medium-term purposes On the other hand again there is the category of small industries where the technique of assessment of possibilities of profitable development is, in any case not so well developed, and where credit to semi established enterprises may have to be based on character and creditworthiness over and above mortgage of assets

All this should hold good provided the bank s lack of medium term and long term resources is made good and the scheme is administered with adequate safeguards for the liquidity and stability of the banking structure by not allowing them to use any of their own short term resources for the purpose The proposed enlargement of the bank s role in the sphere of finance for industry is by no means an ideally satisfactory arrangement and may not, indeed, be good for all time to come But for the time being, owing to the urgency of adequate response to the growing demands of rapid industrialization, it is necessary to use the available resources of banks to the best advantage for the purpose A certain amount of *combination of functions or multi purpose growth* of the banking structure appears therefore unavoidable The enlargement of medium term assistance by banking system need not involve any radical departure from the traditions of Indian banks As the law stands at present, *there is no legislative prohibition of medium term or even long term advances by the banking system* against the security of (and for the purpose of financing) fixed capital *subject to the observance of liquidity ratio as required in terms of Section 24 of the Banking Companies Act*

Citing the example of the U S, where even an unknown man with a sound industrial scheme could obtain credit assistance from a bank or a group of banks and where technical assistance was also given to a prospective industrialist to improve upon his scheme Shri H V R. Iyengar Governor of the Reserve Bank of India said at a press conference sometime back that Indian banks should take bold steps in developing term lending to assist industrial progress Similar suggestions were made to Indian banks at a *Seminar on U.S Banking and Investment* organized at New Delhi by the Technical Co-operation Mission in March 1960 The Seminar discussed the desirability of Indian banks adopting some of the investment practices obtaining in the U S and thus playing a more effective role in

the economic development of the country Speaking at the Seminar, Mr. B R Bhagat, Union Deputy Minister of Finance, said that banking and investment methods in India required to be modified in the light of the changing needs of the country's developing economy He commended the grant of fairly long-term loans by banks to industrial concerns and felt that this was possible under the changing pattern of resources of credit institutions In his opinion the responsibility of banks managements to utilize their increased resources in ways which would help five-year plans and not inflationary or speculative activity was correspondingly great The Reserve Bank of India in its annual report for 1959 on the 'Trends and Progress of Banking in India' also suggested that large Indian banks should extend medium-term credit to industry The report says the pattern of planned development to which Indian economy is committed makes it incumbent on banks to enter new lines of business and term lending to industry is obviously a new line of activity which banks with large resources can consider to the benefit of the economy as well as themselves

The banking system in India and abroad has acted favourably to these ideas and ideals in recent years A study of contemporary banking in Europe, America and elsewhere shows that banking in each country has been conditioned according to its national requirements The new lines of business which certain selected commercial banks in India have undertaken or are likely to undertake safely and beneficially are the following

(a) Consumer credit or personal loans ,
(b) Hire purchase finance ,
(d) Underwriting of new issues of shares and debentures , and
(c) Deferred payments agreements

Consumer credit or personal loans[1] The distinction of coming out first with a scheme for providing such consumer credit or personal loans in this country, goes to the Pandyan Bank Ltd , Madurai (Madras State) The scheme is said to have met with good success Taking this lead, another bank from South India, the Indian Overseas Bank Ltd , announced a personal loan scheme The Devkaran Nanjee Banking Company Ltd (Dena Bank Ltd), has also worked out a similar scheme

Under the Indian Overseas Bank s scheme, its customers can own a wide range of durable consumer goods such as cycles, scooters, motor-cycles, motor cars, radios, electric fans, electric motors, sewing machines, furniture, sanitary equipment, refrigerators, air conditioning plants, agricultural equipment and X-ray and other equipments for medical practitioners The Bank also provides loans for property

[1] In America it is known by several names, some of them which are widely advertised are instalment loans, consumer credit, hire purchase, time plan personal loans etc

improvement and small business and for refinance loans to hire purchase agencies

Only those who have an account with the Bank are provided with personal loan facilities Any one who has the will and capacity to repay is eligible to borrow, not on that frightful term repayable 'on demand', but in easy monthly instalments running as long as thirty months All that he should do is to share, in confidence, with the Bank full information on his steady income and what he has to provide therefrom The Bank s official discusses the loan requirement and sees what he can do to help the customer The borrower has then to contact a dependable dealer who can be relied upon to sell the article he requires in good condition He has to deposit with the bank a small portion of the cost as may be agreed with the Bank, and the latter will then pay the dealer the full cost of the article and the customer will become the owner of the article

The Bank recovers the instalments from the customer's account and sends him an advice In his own interest, the customer is advised not to buy second-hand goods The goods purchased under this scheme certainly belong to the customer, but, until he pays the final instalment, he has to give an undertaking that the Bank has interest in the goods Naturally, the Bank expects the customer to take good care of the goods So long as this is done and the customer continues to enjoy the use of those goods and fulfil the conditions agreed upon at the time of taking the loan, the customer has unrestricted use of the goods

The minimum amount that one can borrow under the scheme is Rs 150 If the customer's regular income permits repayment of loan amounts every month, he can even borrow up to a maximum of Rs 10,000 The rate of interest to be charged on the loan is 6% per annum and this is payable in advance on the total amount of loan and for the whole period of the loan In other words, it will be deducted from the loan amount It saves the customer from the botheration of remitting interest monthly, quarterly or yearly The following table gives an idea of monthly payment one has to make on loans for various periods

Period	*Amount of Loans Rs*	*Discount Rs*	*Net Proceeds Rs*	*Monthly Payment Rs*
30 months	1,200	180	1020	40
24 ,,	1,200	144	1056	50
18 ,,	1,800	162	1638	100
12 ,,	1,200	72	1128	100
6 ,,	1,200	36	1164	200

Penalty for non-payment—Since interest is collected in advance, the effective rate of interest on the aforesaid credit will be more than 6%, varying between 7% and 9% If, however, the customer likes to save some interest and repays the loan in advance, he will get a rebate of interest In case he is unable to repay an instalment in

time, the Bank may permit him to pay the overdue instalment with a penalty of 1 P per rupee, provided it is paid before the close of the month in which the instalment is due and provided the bank is satisfied with the explanation for not paying the instalment in time The Bank has, of course, the right to seize the concerned goods if the borrower fails to fulfil his part of the contract, but the Bank will do so only when forced to the extreme In the event of the death of the borrower before instalments are paid, the burden of repayment will fall on the family In order to avoid this the customer has to take out a life insurance policy and assign it to the Bank Incidentally, the scheme provides a fillip to life insurance business also

A peculiar feature of the Dena Bank's scheme is that the personal loan will be a clean one and will not be secured by the goods, as is the case with the Indian Overseas Bank's scheme Secondly, if the borrower dies during the currency of the loan the burden of repayment will not be cast on the family, and the Bank will write off the loan In order, however to cover the loss, the Bank will take out a life policy and get the amount of loan due from the insurer In this case the premium will, no doubt, have to be borne by the borrower but this will be small and included in the amount of discount which will be deducted from the loan amount in advance

Advantages—The personal loan scheme has fourfold advantages In the first instance it is a beneficiary loan, helping customers to equip themselves with the ordinary comforts of life or to make a start in business or profession Secondly, it will lead to an improvement in the standard of life of the borrower Thirdly it may help him get a rebate on income-tax Fourthly it creates consumer demand for goods which are not within the reach of the fixed income or low income group and thereby assist the industrial development of the country

Personal loan or *consumer credit* as it is known in the U S, *promotes consumer demand* by creating a market, *boosts production, increases employment opportunities, adds to tax revenue* and *gives an upswing to national prosperity* It broadens the incidence of consumer demand, *evens out purchasing power* and *balances price relationship* Secondly, consumer credit gives fillip to consumer industry towards a balanced economy Disproportionate weightage to basic industry without adequate development of consumer industry can well pose serious problems *on the price front and inflation control* And while basic industries are being established under state initiative as the keystone of national economy, consumer industries, numerous and varied have to rest necessarily on the initiative of private enterprise, and no entrepreneur can stand it without a market Again, consumer preference will be a guide to rationalization since the ultimate success of an industry will rest on its ability to satisfy consumer wants

Consumer credit in U S is a measure of widespread ownership of houses, automobiles, household appliances and all other

consumers' durables A third of all retail sales in the U S is on credit and instalment credit and has fulfilled the twin functions of promoting consumer demand and releasing the production potential of factories Dealers have to secure buyers for about 6 million new automobiles every year, a greatly excessive number of used cars, refrigerators, washing machines, television sets, etc While sales finance companies, consumer finance companies, personal finance companies—institutions which assume credit and collection functions for their customers by purchasing their receivables without recourse to customers for credit losses—have done yeoman service to popularize this mechanism, the effective stimulation of consumer credit is started with the participation of commercial banks

A bank executive characterized the 'personal loan' as another version of democracy in the U S , the man in the street can obtain credit with the same ease with which the General Motors Corporation can. Each bank has tried to outwit the other in personal loans service and now this financing covers practically all sort of loan requirements payment of medical bills, taxes, insurance premium, making cash purchases, going on vacation, etc , and 'education loan plan' for tuition fees, automobile financing for new and used cars, instalment credit for home appliances, group loans to cover almost the whole household requirements, say at the starting of life by newly married couple, moving to more spacious house, etc , property improvement loans for modernization, repairs and extensions, boat loans, collateral loan plans against bonds and stocks, small business loans up to $ 25,000 repayable in monthly instalments extending to 50 months

Banks in India can make a useful contribution to economic evolution by a studied phasing of consumer credit For example, *they can assist the artisan to take modern implements* and power We are fast developing electrical energy, and Indian companies produce lathes, electric motors, etc The Indian artisan, who is still weighed down by primitive methods, can give precision and speed to his products, can reduce drudgery of work, *if only he has the* means to equip himself Each 'slum' of the artisan can rise into a small factory of five or six people This will increase their standard of living and reduce the evils of gigantic units Socially, such a scheme can have a sobering effect on the individual and the society itself and be a step towards the 'welfare state' Banks can similarly assist in providing building equipments, road making equipments, etc *They can help installation of sanitary equipments*, electric fans, purchase of furniture, sewing machines, typewriters, radio sets, musical instruments, washing machines, motor-cars, scooters, bicycles, etc They can finance road and water transport agencies and reduce the strain on railways They can assist house *building*, modernization electrification , can promote education, particularly vocational, by appropriate loan plans In short, bank finance can open up vistas yet unknown in this country and can revolutionize living standards And the psychological impetus to extension of

banking habit will place in Indian banks an influence and power not known before

Hire Purchase finance Hire Purchase, in its pure form, is an agreement to hire goods with the option to buy them after paying an agreed number of instalments It is an easy method which enables persons of small or moderate means to own industrial equipment and machinery or other lasting assets Recent economic researches in the U K have revealed the importance of Hire Purchase as a major weapon by which the ordinary much-administered citizen of a welfare state can assert his interest as a consumer, and has also established that Hire Purchase is a powerful means of speeding the creation of wealth The durable goods for which Hire Purchase is most often employed lend themselves to large-scale production methods that are highly mechanized and increasingly automatized Hire Purchase has put machinery and equipment at the disposal of firms that might not otherwise have been able to raise the capital to buy them, and it has enabled wage earning families to buy consumer durables much sooner than they could have done without it Without Hire Purchase the growth of new small and medium-sized firms would have been slower and the ability of families of modest means to enjoy modern 'luxuries' would have been less By making the cost of capital equipment and the prices of consumer durables lower than they otherwise would have been, Hire Purchase has quickened both the competitive tempo of industry and the rise in living standards

The most important development in the British banking world in recent years particularly since 1958, has been the deviation of commercial banks from their traditional pattern of business to the direct participation by almost all the big banks in the hire purchase system They have done so by taking a sizable interest in the share capital of hire purchase finance houses Britain has passed the Hire Purchase Act which came into force on January 1, 1965 to protect the public against sharp practices [1] Consumer credit in the U K is estimated above £ 1,000 million, of which about half is hire purchase debt on consumer goods, and at least £ 100 million worth of industrial equipment is bought on hire purchase [2] Between the short period of nine years (1952 61), the hire purchase debt in the United Kingdom jumped fourfold from 250 million pounds to 1,000 million pounds [3] The latest development in Britain of buying shares on hire purchase is a dramatic illustration of the constructive way in which this kind of credit can be expected to develop as an integral element in the evolution of a middle-class economy

In the United States,[4] some 40% of the total hire purchase

1 *Commerce* dated 9 1 65
2 *The Eastern Economist*, Vol XXXIII, No 24 (11 12 1959), p 933
3 IRTDA News Letter 31 7 65, p 9
4 Hire purchase has had a great boom in the U S over the decade 1951-61 During this period population increased by 19% and the gross national product by 56%, but hire purchase transactions rose by 220% (sales of motor cars on hire purchase increased by 320%) *Commerce*, dated 11-5 63

business of the country is handled by the banks In the U S, banks have their own hire purchase finance service In Australia, all the major trading banks have entered into close association with the hire purchase institution, by acquiring a share in the capital structure or in one case by establishing a wholly owned subsidiary Thus, hire purchase is a rapidly growing field of activity, closely associated with banking

The hire purchase business in India also offers a vast scope It can make considerable contribution to improvement of the standard of living A beginning has been made in the field of motor transport, machines to small scale industries, electrical and household articles, sewing machines and tractors, etc In motor transport approximately 80% of commercial vehicles and 30% to 40% of passenger cars are bought on hire purchase, the monthly volume falling on hire purchase is estimated at about 6 to 8 crores of rupees[1]

Indian banks can also rise to the occasion by serving the national need It will provide them an opportunity for broadening their activities The public, too, is likely to gain, as with increasing competition in this line of business, cheaper credit from banks to finance houses and lower rates of interest offered on deposits from the public, the hire purchase charges may tend to decline The expansion of hire purchase business will stimulate the offtake of such manufactured goods as motor vehicles (both commercial and private), refrigerators, TV sets, radios, kitchen equipment, furniture and other consumer durables

The Law Commission drafted the Hire Purchase Bill in 1960[2] with a view to accelerate the growth of motor transport in the country It is an omnibus legislation drafted to modify all the laws relating to hire purchase Under the proposed draft, the vehicles sold will become the property of the purchasers and the realization of the monthly instalments remaining unpaid will have to be through a law suit Thus, by the time the decision is given, the vehicle would have depreciated in value It has, therefore, been suggested that the clause relating to restriction on right to seize should be modified so that the right to seize non judicially is not limited unless at least two-thirds of the hire purchase price has been paid punctually The Ministry of Transport have also suggested certain other changes Some of the provisions of the Bill have direct relevance to the hire purchase system of commercial vehicles The Bill has not yet been enacted into an Act The Reserve Bank of India has, however, taken powers since April 1962 to call for information from hire purchase agencies with a view to regulate hire purchase business The bank requires information of deposits relating to such business every six months

As suggested by the State Transport Commissioner's Conference held at Bombay in November 1960 the Ministry of Transport

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1 IRTDA News Letter, 31-7 65 p 9
2 *Economic Times*, dated 6th and 7th January, 1965

has also prepared a Model Scheme The scheme seeks to enable private operators to purchase vehicles on a hire purchase basis

Underwriting In tune with the rising requirements of a developing economy, banks would be called upon to extend a variety of services to cater to the varying needs of business and individuals Banks in India have already ventured into the sphere of underwriting of new issues, especially preference shares and debentures

According to a study of underwriting of capital issues by Mr L C Gupta for the period 1955-59,[1] the commercial banks as a group in India emerged as the most important underwriters accounting for 39% of the total amount underwritten during the period [2] The banks which participated in these underwriting operations were The Central Bank, The Union Bank, The Baroda Bank, The United Commercial Bank and The United Bank of India Other banks which have underwritten shares and debentures in recent years include the Bank of India, the Indian Overseas Bank and the Devkaren Nanjee Banking Co Ltd While this is a welcome feature, it is necessary that in view of the inherent risks of this business, certain safeguards and limits are adhered to by the banks in the discharge of their service

According to the figures compiled by the Reserve Bank of India, the share of banks in underwriting issues came to 18 7% during 1960-63 [3]

Deferred payments agreements It is gratifying to note that Indian banks have been instrumental in the conclusion of deferred payments agreements between the units in Indian industry and foreign collaboration firms

These are indications of progress on right lines Similarly there are other directions in which banks can take the initiative and can confidently look forward successfully to meet the challenge thrown up by the Fourth and subsequent Five Year Plans

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1 *Commerce*, Annual Number, Dec 1959 pp 172 75
2 See page 227
3 See page 228

13

Working Capital & Current Finance

The total assets of a business are usually divided into two broad groups called fixed assets and current assets To denote these groups the terms fixed capital and working capital are also used The division is physical as well as functional and is derived from their form and use both The fixed assets are usually in a permanent and unchangeable form and they are meant for use over a long period of time the current assets on the other hand change their form over a comparatively very brief period of time Finance for acquiring fixed assets is obtained on a long term basis by selling long term securities like shares and debentures The finance obtained by issuing equity securities is to remain in the business till the corporation or the company remains in existence The equity securities might change hands several times during this period but the finance contributed initially cannot be withdrawn unless the company goes into liquidation But the finance for current assets is obtained on a short term basis by using short term paper like the bills of exchange hundis or notes Funds for this purpose may be obtained even without the use of any credit paper on an open account basis The suppliers of short term funds expect to get back their money after the exp ry of the short period for which they agreed to permit the use of their funds

As mentioned earlier the term fixed capital is used for the funds obtained on a long term basis and the term working capital is used for the funds obtained on a short term basis A number of other terms like circulatory capital short term capital revolving capital current capital trading capital etc are also used to signify working capital Usually these terms denote and emphasize the short term or changing nature of the capital They signify capital in action i e dynamic as opposed to static

The term working capital is somewhat vague and cannot be used to give an exact and precise meaning For that purpose it has to be qualified by the addition of the words gross or net The term gross working capital is used to denote the total value of all the current assets like (a) cash (in hand or in the bank) (b) marketable

securities, (c) accounts, notes or bills receivable, (d) stocks of raw materials, semi-manufactured or finished goods, (e) stores of supplies or consumables, etc

The current assets represent a stream of current value that is flowing and growing They are expected to change their form quickly—cash into raw materials, raw materials into semi manufactured and finished goods, finished goods into stocks, stocks into accounts receivable and the accounts back into cash again to be used for buying fresh raw materials and for continuing the operations The stream is expected not only to flow but to grow also as it flows if profits are expected to be made Properly speaking a part of fixed assets also gets mixed up with the stream to swell its size in the form of depreciation through the prices of goods sold The cash which enters into the stream of operations in buying raw materials should grow in volume when it re-emerges from the accounts receivable From this point of view not only the amount of working capital but the speed of its turnover or rate is equally important for efficient performance

The concept of gross working capital is useful in a number of situations The proportion of fixed and working capital varies from industry to industry The ratio to be found in leading successful plants in a particular industry may be taken as a guide or model for other units in the same industry This ratio may also be adopted by new plants in the beginning The concept of gross working capital is also helpful in the analysis of costs and prices under the condition of monopolistic competition Fixed costs are related to the use of fixed capital while the variable costs and the marginal costs are obtained by comparing varying volumes of production with the use of varying amounts of working capital Keeping in view the demand for output and the price at which it can be sold, the optimum size of a plant is dependent upon suitable combination of fixed and working capital Maximum profitableness as well as the proper size of a plant in a given industry is determined by the behaviour of fixed and working capital when they are combined in varying proportions If we associate fixed capital with machinery and working capital with labour, in a country like India, the concept of gross working capital has great practical utility in determining the question of the degree of mechanization The decisions to use more of machinery or more of labour to obtain maximum profitability are related to the determination of proper ratio between fixed and working capital

The gross working capital is represented by current assets appearing on the asset side of the balance sheet The current assets give an idea about the manner in which the gross working capital is employed How much of it is actually in the form of cash, how much of it is in the form of short-term paper like notes, bills or hundis and accounts receivable, and how much is in the form of materials and goods—raw, partly manufactured or finished A study of this type of distribution of the total value of gross working capital among

the various items of current assets may give some idea about the economic and efficient utilization of working capital and the health of the business unit Cash should not be more than what is required to meet normal day to day needs purchases of raw materials should not exceed the requirements of production and the stocks of finished goods should not be larger than the quantity that can be sold profitably Anything less than perfect co ordination between these sections would indicate less than perfect economy of working capital Cash in hand or in current account is the idlest of all assets as it earns nothing Similarly other idle current assets in excess of actual needs whether raw materials or finished goods are not economical to hold Disproportionately large amount of cash accounts receivable or stocks might show that the business unit is not in good health It is on account of these things that the use of working capital is allocated to different items of current assets on a planned basis and is given the shape of a business budget and budgetary control is used as a device to obtain the most economic use of working capital

Net working capital—The concept of gross working capital is related to current assets which appear on the asset side of the balance sheet On the liability side of the balance sheet other items of a similar temporary nature are shown they are called 'current liabilities Items like accounts payable, bills payable, accrued and unpaid expenses etc, are included in this category If the total amount of current liabilities is deducted from the total amount of current assets the remaining balance will be called the 'net working capital

If the net working capital is a positive quantity, it is presumed that it reflects the strength of the business to meet its current obligation in a satisfactory manner because amounts likely to be received through the realization of current assets are more than the amounts likely to be paid in order to meet the current liabilities *Current ratio* obtained by dividing the current assets by current liabilities is really another way of making use of the concept of the net working capital A ratio of two (current assets) to one (current liabilities) is considered to be satisfactory for advancing loans by the bankers A comparison of stocks with current liabilities is also used for testing the liquidity of a company If the value of stocks is higher than the total amount of current liabilities the liquidity is considered to be higher than it would be if the difference between the two was very narrow or nil For determining the creditworthiness of a company for the purposes of short term credits the make up and past and prospective behaviour of the net working capital of the company is also studied and examined In brief when both the current assets and current liabilities are taken into consideration for purposes of analysis it centres round the concept of net working capital directly or indirectly, in some form or the other, and the main purpose of all these types of analyses is the testing of the liquidity and credit worthiness of a company for the purposes of short term credits

Types of working capital

The requirements of working capital are not the same throughout the year They vary from one part of the year to another More working capital may be required during the busy season or the peak period of business activity and less may be required when the business activity is not so brisk or the season is dull According to the varying needs of business the working capital may be classified into two broad groups (1) the regular or the permanent working capital, and (2) The variable working capital

(1) ***Regular or permanent working capital*** The average volume of production and sales of an established business during a period of normal business activity is fairly known Say for example, a shoe manufacturing company is able to manufacture and sell about 12,000 pairs of shoes annually On the basis of this amount of business and of production and sales it is possible to calculate the amount of funds required in the form of current assets like cash, stocks of raw materials and finished goods accounts receivable, etc The total amount of funds required to maintain the current assets at the required levels will represent the amount of working capital which may be called regular or permanent working capital because this amount will be required continuously so long as the levels of production and prices remain unchanged

This working capital is as permanent as the fixed capital, the units of current assets representing the regular working capital like raw materials or finished goods and accounts payable will continue to change their shape or form and will flow in and flow out but the total amount invested in them will remain approximately the same Because these funds are required permanently during a particular period of time of sufficient duration so from the theoretical point of view they cannot and should not be borrowed on a short-term basis, they should be obtained on a long term basis either from the shareholders on the basis of equity securities or from the long term creditors on the basis of debentures or bonds

Some of the writers divide the regular or permanent working capital into two sub-classes (a) primary working capital, and (b) normal working capital

(a) *Primary working capital*—Primary working capital according to these writers represents the irreducible basic minimum working capital Some amount of cash is always necessary to pay petty expenses, electric charges, wages etc, minimum quantity of raw materials at least to start operations, and the minimum quantity of finished goods to represent ranges of size and style to attract customers are absolutely essential, old accounts will be paid and new credits will be extended but a certain amount of accounts receivable will always remain outstanding The total value of these basic minimum current assets represents the amount of working capital called 'primary working capital' This portion of the working capital is as permanent as the fixed capital

(b) *Normal working capital*—As primary working capital represents the basic minimum to start the operations so the normal working capital represents the amount of working capital required to maintain the operations of a company at an average normal level during a period in which business conditions are normal These average normal requirements may be different for different periods according to the changes in the level of operations which are regarded as normal for a particular period Both the primary and normal working capital taken together represent the total amount called regular or permanent working capital The entire amount should be provided from the funds obtained on the basis of long term securities—shares and debentures or from the retained earnings of the business because the nature of this fund is permanent in spite of the fact that the current assets which represent this amount continue to change shape and form and to revolve at regular intervals.

(2) *Variable working capital* The operations of all types of businesses cannot always be carried on at the same pitch Most of them experience busy and slack periods During the busy periods the current assets have to be expanded and more working capital is required to meet this need for expansion of current assets, but during the slack periods the volume of current assets has to be contracted and consequently less working capital is required to be invested in the contracted volume of current assets This amount of working capital which expands or contracts at particular periods is called the 'variable working capital The extra amount of working capital which is required to acquire additional current assets at the time of the busy period has generally to be obtained for short periods from sources outside the business unit itself Reasonably and logically the company should not try to meet the extra requirement of the additional working capital during busy periods from its own resources because this would amount to the possession of idle funds not fully employed during the slack period. This extra burden of carrying idle funds during the slack period would reduce the earnings and profitability of the business Naturally, these funds are provided by institutions like commercial banks which specialize in the business of providing short-term funds

The variable working capital is again sub-divided into three sub-groups (a) seasonal, (b) cyclical, and (c) special or emergency working capital

(a) *Seasonal working capital*—It is the most important one of all the three types Seasons play a very important part in creating fluctuations in the supplies of raw materials of agricultural origin Raw materials like raw cotton or jute are harvested at a particular time of the year Stocks of raw materials are built up usually by the manufacturing industries at this time and they borrow additional short term funds to meet the situation. As the raw materials are turned into finished goods and sold during the normal course of working of the industry, the funds are released and returned to the agencies from which they were obtained In the case of

the sugar industry of India, which uses a fresh raw material—sugarcane—the working season commences usually in November and continues up to March or April. A major part of the sugarcane crop has to be purchased by the sugar mills and crushed during this period of about six months. The industry has to borrow additional working capital to finance these operations on a short-term basis. The short-term advances are paid from the funds obtained by the sale of white sugar gradually during the slack season. The woollen industry of India is also very seasonal. In northern India woollen cloth is sold from October to February only. But the mills have to carry on their operations during the slack season also to make the stocks available to the trade in the month of October after the rainy season. Additional stocks of finished goods during the slack season are carried by the industry with the help of borrowed funds obtained on a short-term basis to be returned in winter when the stocks are disposed of. The same element of seasonality exists in paper pulp (North temperate zone), beet sugar, rice-milling, flour milling and fruit canning industries. It is not economical for a particular industry to meet the requirements of additional seasonal working capital from its own resources but it is quite profitable for institutions specializing in the provision of short term funds at the time of busy seasons because the peak or busy seasons of different industries do not coincide but rather fall in different parts of the year and the funds withdrawn from one industry are passed to the second and then to the third and so on and are profitably employed throughout the year.

(b) *Cyclical working capital*—As there are busy and slack seasons during the course of the year, so there are busy and slack periods of business activity of a longer duration usually called booms and depressions during the course of a business cycle. During the boom period additional working capital may be necessary for financing expanded operation to meet brisk demand and during the depression more fund may be needed to fill in the gap caused by operating losses. During both types of periods the usual agencies of providing short-term funds may not be in a position to provide the funds so badly needed. During the boom period the resources of these agencies are under a very severe strain on account of greatly increased demand for funds and they are not in a position to meet the requirements of the users in full and during the depression there is great reluctance to provide additional funds on account of the fear of the failure of some of the borrowers. Under these circumstances the requirements of cyclical needs may have to be met from sources other than those which provide the seasonal funds.

The cyclical fluctuations do not affect all the industries in the same way. Well established and financially strong units, whose wise managements have tried to conserve substantial resources in the form of reserves, try to meet the additional requirements of funds from their own resources. Methods of operations followed in certain other industries are of such a nature that the volume of production can be adjusted to the variations in demand, it can be expanded

under boom conditions and can be curtailed during the depression Such industries can manage to pass through the depression with less working capital But the companies working in industries where the proportion of fixed expenses is large have to suffer operational losses and cannot remain in the field without additional supplies of working capital No better source than conserved earnings in the form of reserves can be suggested for meeting the additional requirements of working capital during the periods of brisk business activity and for filling in the gaps created by operational losses during the period of depression

(c) *Special or emergency working capital*—Besides the requirements of additional working capital for meeting seasonal and cyclical fluctuations in the scale of operations additional working capital may also be needed to provide additional current assets to meet the demands created by unusual or unexpected events Such situations may be created by disasters caused by nature in the form of floods, droughts or fires which might destroy current assets Usually provision for such contingencies is made by taking out insurance policies but even then more funds than can be effected from the insurance companies are generally required for the replacement of lost current assets State of emergency created by the danger or the actual breaking out of a war may also bring about a special spurt in the production of defence or war materials requiring huge amounts of additional working capital all of a sudden This type of special or emergency capital can be provided only from other than traditional or usual sources of meeting the requirements of variable working capital

Reasons for differences in the requirements of working capital

The needs of working capital differ from industry to industry In some industries like the public utility services the consumers are generally asked to make payments in advance and the money thus received is used for meeting the requirements of current assets Such industries can carry on their business with comparatively less working capital In textile industries like jute or cotton a major part of the requirements of raw materials for the whole of the year may have to be purchased during the harvesting season and labour charges form a very substantial part of their manufacturing costs Such industries require comparatively more working capital In certain other industries like leather tanning, the vegetable tanning process takes about six months In such cases more funds are required to be invested in current assets like goods in process But in case the finished goods are sold quickly the amount invested in goods-in-process may be treated more or less like an item of fixed assets More working capital is required by those industries which, like the woollen textile industry of India, pile up their finished goods for seasonal sales In industries like the manufacture of agricultural implements the period of credit to be extended may be a long one.

The farmers are usually able to meet their obligations after the harvesting of their crops and in a country like India where the Rabi crop is harvested in April or May and the Kharif crop is harvested in October or November, the payments from the farmers can be expected usually twice a year at the time of the two harvests The period of credit in such cases has, naturally, to be long Compara tively more working capital will be required by such industries By adopting wise and efficient practices of management the requirements of working capital may be reduced to a certain extent The stocks of finished goods may sometimes be financed partly by the advanced deposits from the middle men or the extent of credit may be reduced by adopting a judicious policy of cash discounts offered to the debtors for making payments before the expiry of the period of credit

Advantages of possessing adequate working capital

The total requirements of working capital may be different for different industries but an adequate provision of working capital is essential for all The cost of carrying on the operations has to be met in cash in paying for materials labour, stores etc Sufficient working capital is necessary to arrange the payments when they fall due Failure to achieve this may bring about technical insolvency, where a business does not possess enough cash at particular time to meet its obligations in spite of the fact that ample total current assets and resources are there which could be converted into cash if a little more time could be gained for the purpose Firms possessing adequate working capital are not only in a position to take advantage of cash discounts to increase their profits but the punctuality in arranging payments enhances their creditworthiness in the market Credits from banks and other sources are easily and readily available whenever they are required Even for arranging timely payment of dividends to shareholders liquid resources of working capital in the form of cash are essential To sum up, enough working capital is as essential for maintaining the efficiency of operations of a strong business unit as the presence of enough blood is necessary in the body of a strong man to keep him fully active A business which takes ample working capital can be likened to an anaemic man unable to carry on normal activities of life

Sources of working capital

According to conservative principles of financing, (a) the fixed assets should be financed from permanent sources, i e , the funds for fixed assets should be obtained on the basis of shares and debentures , (b) an amount equal to the basic minimum of current asset needs, i e , the primary working capital should also be financed from long term sources represented by shares and debentures As far as possible the normal working capital should also be provided from internal sources , (c) only the seasonal or short-term needs should be

financed from short term sources These principles imply that of the two types of working capital discussed earlier the first type—the permanent working capital—should be obtained on the basis of long term securities i e the shares and debentures and only the second type—the variable working capital—should be obtained on a short term basis

In practice however these principles are used in a substantially modified form With the exception of large and strongly financed concerns most other businesses use short term credit almost continuously Small business units regard short term credit obtainable from commercial banks or other sources as a convenient form of revolving fund of working capital to be used so long as it is required and is available on the basis of their credit standing which they try to maintain by promptness in payment of individual items of credit as they mature and fall due for payment

In Britain the most important sources of short term finance are (1) the trade debts (2) bills of exchange (3) bank loans, and (4) inter-company loans Practically every business unit both gives and receives a certain amount of current finance in the form of trade debts because every purchase and sale not immediately paid for in cash results in a temporary debt This form of credit is rather considered to be costly because if the rate of cash discount offered for prompt payment is taken into consideration the interest charged on these credits comes to about 10 per cent per annum It is on account of this fact that the merchants and manufacturers grant credit to firms with little capital of their own These merchants and manufacturers are able to get credit from banks on lower rates and the margin between the two rates enables them to meet bad debts if there are any About a century back the bills of exchange formed the basis of trade credit At the present time most of the businessmen prefer the more flexible and less public form of credit represented by book debts Bills of exchange are still commonly used in foreign trade For firms with sufficiently good credit standing and with fluctuating requirements of short term funds bank overdraft is the most convenient and extremely economic form of credit In Britain companies have become increasingly integrated into groups under the same control and consequently inter-company loans have gained in importance Temporary cash surplus of one company can conveniently be used for meeting the temporary financial needs of another company

In the U S A the permanent working capital is expected to come from the stockholders bondholders and similar other sources of long term finance and the sources of short term funds are (1) the Commercial banks (2) the Commercial Paper Houses (3) the trade creditors (4) the finance companies (5) factors and (6) miscellaneous agencies

Bank credit is available in many forms the most important of which perhaps is the *unsecured loan* This type of loan can be obtained in two ways the credit can be extended on the basis of

either an unsecured single name paper or an accommodation paper The first is self-explanatory, the second is a two-name paper It bears the signatures of the borrower as well as the endorsement of another individual accepting the secondary liability The most commonly used form is the unsecured single name paper On the basis of one of these papers the maximum limit of the amount to be lent at one time usually called the line of credit, is determined After this the borrower is permitted to obtain loans up to that limit without any further negotiations

Loans are also made on the basis of the *assignment of the accounts receivable* As a first step in the process the bank satisfies itself about the purpose of the loan and the quality of the accounts of the customers to be pledged The maximum amount of the advance and the terms of the loan are worked out and then the borrowing company enters into a formal contract with the bank Usually, 70 to 90 per cent of the total amount of the accounts pledged is advanced Generally, the debtors are not notified about the fact of their accounts being pledged with the bank and when the payments are received they are endorsed to the bank If some of the accounts pledged remain unpaid at maturity they are taken over by the borrower

Banker's acceptances are quite popular in the financing of foreign trade The buyer of goods enters into an agreement with his bankers whereby the bank undertakes to accept the drafts drawn by the seller on the bank up to a certain specified limit covering specified merchandising transactions Ordinarily a commercial letter of credit is issued by the bank to the customer who sends it to the seller to assure him that his draft on the bank will be accepted The buyer arranges to make funds available with the bank a little in advance of the maturity of the acceptance Banker's acceptance commands a better market in comparison to a trade acceptance on account of the financial strength of the bank

Commodity or Merchandise loans have also become an important source of current fund These loans are usually taken by companies engaged in the storage, processing or shipment of staple commodities like cotton, copper, rubber, tobacco, wheat, etc, which are of a standardized and non perishable nature and which consequently enjoy good marketability These commodity loans are usually secured by one or more of the three types of documents (1) Bills of Lading, (2) Warehouse receipts, and (3) Trust receipts

The Bill of Lading issued by a common carrier as a receipt for goods is usually attached to a Bill of Exchange drawn by the seller on the purchaser The Bill of Exchange may be a demand draft or acceptance These documents are lodged with the bank for obtaining an advance by the seller The buyer takes delivery of the goods by obtaining the documents from the bank on payment of the demand draft or after accepting the Bill of Exchange, the payment of the Bill is arranged at the time of maturity

Warehouse receipts are issued by a bonded and licensed warehouse on receiving the goods for storage These receipts are used as security *for bank loans by the owner of the goods Both of the* documents mentioned above are used extensively in all the countries for obtaining bank loans or advances

In the U S A., Trust receipt is also used as a security for bank loans The receipt enables the buyer of the goods to take possession of goods but he does so only as a trustee the title to the goods remains with the bank When this type of merchandise is sold a release has to be obtained from the bank either by paying for the goods or by obtaining a new credit on the basis of the sale

There are a few other methods of obtaining short-term finance from the commercial banks sometimes the notes receivable are *discounted with the bank In most lines of American business the* notes receivable do not form the basis of extending credit by the companies to their customers and therefore the practice of discounting or pledging the notes receivable at the commercial banks is not *common for obtaining short-term funds* But when a bank advances money on the basis of these notes, these notes are endorsed by the borrower making them two-name papers Trade acceptances or ordinary bills of exchange drawn upon customers for merchandise and accepted by *them at the time of sale are also not popular with* the banks When the seller who is the drawer of the bill wants to borrow from the bank offering the bill as a security he discounts it with the bank after endorsing and thereby assuming a contingent liability in case of failure of *the drawee to pay it* Loans on the basis of instalment paper are, however, becoming more popular. The instalment paper held by the seller represents the sale of durable consumer goods usually in the form of a conditional sale These papers are used as a collateral security by the dealers or retailers for obtaining a bank loan More usual form of arrangement, however, is that the bank buys the paper with or without recourse to the dealer and the ultimate consumer makes the payment direct to the bank In reality this method represents more of consumer than of business financing.

There are a number of other institutions which help in the provision of current finances. Two of the important institutions are *(1) The commercial paper houses,* and *(2) the commercial* finance companies The commercial paper houses step in where the short-term funds required by a good and well-established concern for a period of four to six months cannot be obtained in the normal course from a single commercial bank The manufacturer contacts a commercial paper house which sends a representative to look and enquire into the financial position and the business prospects of the manufacturer In case the house decides to handle the transaction, it asks the manufacturer to make out a block of notes of equal amount for the period of four or six months as agreed between the two parties. The notes are made in round denominations of $ 2,500; $ 5,000 *or* $ 10,000 each ; they are made payable to

the order of the maker and endorsed in blank to make them bearer instruments which can be negotiated without further endorsement or contingent liability As the name of the commercial paper house does not appear on the notes it does not assume any liability for their redemption The notes do not bear any interest but are sold to the commercial paper house by the maker at their face value less a current rate of discount A small commission is also charged The notes are usually sold to the commercial banks Unsold notes are also used by these houses as a collateral security for obtaining bank loans Since the notes are neither endorsed nor guaranteed by the commercial paper houses their saleability depends entirely on the reputation and the credit of the manufacturer who makes them

The commercial finance companies are engaged in helping the finance of the economic process of production in its final stage of sale to wholesalers, retailers or consumers Some of these companies are called discount houses or commercial credit houses They advance loans on the basis of the pledge of accounts or notes receivable Two methods are generally used for discounting the accounts one is called the non-notification plan under which the customer is not informed that his account has been sold to a finance company, the amount is collected by the seller of the goods from the buyer and is paid to the finance company at the expiry of the period of credit, the second is called the notification plan under which the customer is informed and is requested to pay the amount direct to the finance company This outright purchase of the accounts receivable is known as 'factoring' and is usually found in the textile trade

Instalment selling has now become very common in consumer durables like automobiles, refrigerators radios, furniture and appliances When these goods are sold to customers on instalment credit terms, a part of the price is received in cash and the balance is represented by instalment paper The instalment paper consists of a series of notes running from 12 to 18 months depending upon the nature of the goods These notes are taken up by the finance companies which are usually called the sale finance or instalment finance companies

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Short-term Finance in India

paid up capital of Rs 1 crore working capital raised by issue of shares has been estimated at Rs 27 lakhs (or 27%) as follows[1]

(Rupees in lakhs)

	Total required	*In share capital*	*Bank advances*
1 *Fixed capital*			
Land	3	3	—
Buildings	10	10	—
Machinery	60	60	—
Total	73	73	—
2 *Working capital*			
Raw materials	30	7 50	22 50
Finished products	10	2 50	7 50
Stock in progress	4	4 00	—
Stores & Spares	5	5 00	—
Wages	5	5 00	—
Other expenses	3	3 00	—
Total	57	27 00	30 00
Grand Total	130	100 00	30 00

(b) *Bank Credit*—The company will not be required to find money by sale of shares for the full value of raw materials and finished products but only up to 25% (of Rs 40 lakhs) of the value i e , Rs 10 lakhs only, the remaining 75% (i e Rs 30 lakhs) will be obtained by way of bank advance on the security of goods The contribution of banks towards initial working capital comes to Rs 30 lakhs or 52 6% of total

(c) *Retained profits*—A small part of the short term finance may be obtained by small firms and concerns from money lenders or other private sources and by large concerns from their own reserves or retained profits Internal sources accounted for Rs 98 7 crores or 63% of the total funds of 1001 companies whose finances have been studied by the Reserve Bank of India[1] but a recent study (1960 61 to 1963 64) reveals a smaller proportion (see p 157)

Importance of bank finance

By far the most important source however of short term finance is the banking system The commercial banks in India are readily forthcoming to finance short term requirements of industry against tangible security In fact, no modern factory or joint stock company can afford to go on without a banking connection Rarely has any factory enough resources saved to handle the financing without the help of a commercial bank

[1] V R Sonalker *Industrial Organization and Industrial Finance* 1959 p 38

[*] Reserve Bank of India Bulletin September 1961, p 1433

It will be noted from the following figures that Indian scheduled banks have rendered increasing assistance towards meeting the requirements of working capital of organized industries of India

Working capital and scheduled bank advances to organized industries[1]

Year	*Total working capital (Rs in crores)*	*Bank advances Rs in crores)*	*% share*
1950	356 38	116 43 June	32 7
1951	437 82	153 71	35 0
1955	463 49	241 20	52·0
1956	541 18	300 40	55 5
1957	599 93	390 40	65 0
1960	899 89	533 00	59 2
1961	712 91	687 79 April	96 4

It will be observed that bank advances to industry have gone up from 32 7% of the total working capital of the industry in 1950 to 52% in 1955 and to 65% in 1957[2] The working capital of 1001 selected public limited companies for the period 1956–59 came to Rs 260 97 crores while their borrowings from banks amounted to Rs 121 36 crores the percentage share being 46 6[3] A similar study of 1333 public limited companies, however, shows that in 1963-64 out of Rs 2010 62 crores of working capital of these companies banks provided Rs 526 80 (i e , 26 1%) only[4] Roughly it may be held that on an average 25% to 50% of the working capital of Indian industries is supplied by commercial banks, the contribution to individual industries may vary from 2% to 41% as shown by the following table

Working capital and bank advances during 1963 64

Industry	*Working capital (Rs in crores)*	*Bank advances (Rs in crores)*	*%*
Iron & Steel	102 51	2·00	1·9
Sugar	92 28	27 19	29 5
Cotton textiles	375 76	143 09	38·0
Chemicals	59 18	23 84	40 4
Jute textiles	92 61	38·02	41·0

1 The figures of working capital have been taken from the *Census of Manufactures* and those of bank advances from the Reserve Bank Bulletin Therefore the percentages worked out may be taken to show only approximate proportions.

2 Banks in India have played increasingly important role in the general industrial expansion of the country It is evident from the fact that during the decade 1951 61 industrial credit provided by the banking system increased by Rs. 410 crores, which has also raised its share from 32% of the total to 50%. Advances of all scheduled banks in 1951 were Rs 580 crores of which 33 5% were for industry By 1956 the advances rose to Rs 794 crores of which 38 5 per cent were for industry In 1960 the advances touched the massive figure of 1100 crores (*Eastern Economist* 23-3 1962 p 751)

3 Reserve Bank of India Bulletin, Vol. XV, No. 9 (Sept. 1961), p 1474

4 Reserve Bank of India Bulletin Nov 1965

Total borrowings of 1001 selected public limited companies for the four years 1956-59 amounted to Rs 249 90 crores, of which banks contributed Rs 121 36 crores (i e 48 6 per cent) During the three years 1961-62 to 1963-64 total borrowings of 1333 public limited companies amounted to Rs 265 crores, of which Rs 152 crores (58%) were provided by banks [1]

Borrowings of selected public limited companies from different sources

(Rupees in crores)

Neme of agency	*Amount borrowed by 1001 cos (1956-59)*	*1333 cos (1961-63)*	*Percentage share (1956-59)*	*(1961 63)*
Banks	121 36	154 17	48 6	58 2
Statutory financial corporations	9 06	10 20	3 6	3 9
Other debentures	4 42	7 39	1 7	2 8
Other mortgages	98 37	24 30	39 4	9 1
Others	16 69	69 00	6 7	26 0
Total	249 90	265 06	100 0	100 0

It may be noted that in recent years there has been a shift on the part of companies from banking to non banking funds In 1961-62 bank borrowings constituted 77% of total borrowings of 1333 companies, but in 1962 63, they declined to 72% and in 1963-64 to 32 5% only, although for a large number of industries bank finance continued to be the major source of external finance [2]

It may be said that nearly half the working capital is provided by commercial banks in the form of advances Similarly, it may also be said that nearly half the borrowed funds of the joint stock companies also come from the banking system It may be pointed out here, however, that all borrowed funds may not be for short periods but these figures do indicate the importance of the part played by the banks in financing joint stock enterprise

Lending capacity of banks

The banker's point of view now may also be considered The extent to which commercial banks may grant financial assistance to a particular business house is determined by the lending capacity of the bank concerned The lending capacity of a bank is limited both (i) by law, and (ii) by financial considerations

(i) *Legislative provisions*—Section 20 of the Banking Companies Act prohibits a banking company to make loans or advances on the security of its own shares, or to grant unsecured loans or advances to any of its directors or to firms or private companies in which it or any of its directors is interested as partner or managing agent or to any individuals, firms or private companies in cases

[1] Reserve Bank of India Bulletin, November 1965
[2] *Ibid*, p 1703

where any of the directors is a guarantor. Under the provisions of section 21, the Reserve Bank of India has been empowered to determine the policy in relation to advances to be followed by banking companies in the interests of the public. The Reserve Bank in particular may give directions to banking companies as to the purpose for which advances may or may not be made and the margins to be maintained in respect of secured advances etc. Under Section 24, every banking company has to maintain not less than 28% of the total of its time and demand liabilities in India at the close of any day of business in the form of cash, gold or unencumbered approved securities. Besides the Act prescribes minimum standards as to paid up capital and aggregate reserves. A minimum of 20% of the net profits have to be transferred every year to a reserve fund by every banking company. A banking company is also required to maintain by way of cash reserve a sum equivalent to at least 3 per cent of its time liabilities and 3 per cent of its demand liabilities. These measures are meant to introduce sound and healthy banking practices and to check over trading.

(ii) *Financial policy*—Financial considerations relate to (i) the total funds at the disposal of a bank in the form of paid up capital reserves and deposits and (ii) the policy of maintaining cash ratio to deposits. In spite of the availability of adequate funds with a bank, it may not be in a position to lend to a high extent because of the maintenance of a high cash ratio. On the other hand, a bank with moderate funds may meet the financial requirement of high order by reducing its cash ratio. The joint-stock banks in India are favourably placed in regard to total resources available. In spite of the decline in the number of reporting banks, the figures of paid up capital, reserve and deposits have shown a rising tendency in recent years and the cash ratio a declining one, as shown below.

Resources of all Commercial Banks[1]

(Rupees in crores)

Year	*No of reporting banks*	*Paid up capital*	*Reserve*	*Deposits*	*% of cash to deposits*
1950	430	40 3	27 1	883 9	12·0
1955	476	40·6	35 6	1082 3	10 2
1956	443	40 8	36 7	1125 1	8·6
1957	409	40 6	39 5	1346 6	8 3
1958	383	41 0	41 7	1562 2	7 9
1959	363	41 2	38 9	1815 5	6 5
1960	344	41 4	33 4	2001 8	11 3
1961	292	39 9	36 5	2088 9	10 8
1962	276	43 5	40 7	2273 6	10·0
1963	248	44 0	43 9	2515·0	9 5

1 Reserve Bank of India—Statistical Tables relating to Banks in India.

It may be noted that the deposits of Indian banks have shown a rising trend since 1950 and the cash ratio has shown a declining tendency These tendencies are noticeable in spite of the number of banks having gone down due to amalgamation and with greater force in the case of scheduled banks The reserves have also shown a rising tendency The deposits of scheduled banks rose from Rs 846 5 crores in 1950 to Rs 1953 4 crores in 1960 and Rs 2481 crores in 1963 With a declining ratio of cash to deposits, a declining tendency is also noticeable in respect of ratio of paid up capital and reserves to total deposits of our banks as shown below

Ratio of paid-up capital and reserves to total deposits of Indian Joint-Stock Banks, 1939–1960

End of	*Scheduled Banks*	*Non-scheduled Banks*	*All Banks*
1939	13	25	14
1945	6	11	7
1950	9	21	9
1955	7	18	8
1960	4	14 3	4 2
1961	3 9	14 5	4 2
1962	4	14 6	4 2
1963	3 8	14 7	3 9

It will be observed that the ratio of paid-up capital and reserves to total deposits declined steadily from 14 in 1939 to 11 in 1952 There has been a sharper decline since then to 8 in 1954 and further decline to 4 2 in 1960 and to 3 9 in 1963 Though this progressive decline in cash and liquidity ratios of banks is an indicator of greater capacity of banks in regard to advancing money to industry, it is not safe to allow a further decline in this respect In view of the rising demand for bank credit anticipated in the Fourth Plan period and in the interest of a balanced growth of the banking system, it is important for banks in general to prevent a further decline in the liquidity ratio and in appropriate cases to strengthen their liquidity

Growing assistance to industry

With the growing prosperity of banks the growing importance of bank credit to industry is evidenced by the large volume of credit made available to industries during the period of the first three plans During the five-year period 1951–55, scheduled bank credit rose by Rs 169 crores of which credit extended to industries accounted for Rs 69 crores or 41 per cent Bank credit to industry during the years 1956 60 accounted for a much larger proportion, because of the increased impetus given to industrial development under the Second Plan Of the increase in scheduled bank credit of Rs 455 crores, industrial credit amounted to Rs 342 crores or 75 per cent Thus, over the decade 1951–60, industrial credit increased by Rs 410 crores or two-thirds of the total increases in bank credit, raising its relative share from 32 per cent to 51 per cent

Increasing bank advances to industry were particularly significant during the latter years of the Second Plan The sharp spurt in industrial advances was occasioned by the coming into production of new industrial units (particularly in engineering, sugar and chemicals) set up in the earlier phase of the Second Plan as well as by the significant growth in the scale of production, following the larger availability of iron and steel The expansion also represented partly the impact of the rise in prices of raw materials and partly the build up of stocks in certain industries

The trend of greater bank credit to industry which began during the Second Plan period continued during the Third Plan is evident from the following figures

Scheduled banks advances to major groups of borrowers

(Rupees in crores)

	Borrower	October 1959 Amount	%	April 1960[1] Amount	%	March 1965[1] Amount	%
1	Industry	418 5	44 7	533	47 4	1287	61 5
2	Commerce	296 1	31 6	370	32 8	537	25 6
3	Financial	77 1	8 3	75	6 6	94	4 5
4	Agriculture	25 7	2 7	19	1 7	4	0 2
5	Personal	68 2	7 3	78	6 9	110	5 2
6	Professional	9 8	1 1	11	1·0	13	0 6
7	All others	40 0	4 3	40	3 6	50	2 4
	Total	935 7	100	1126	100	2095	100

It will be observed that from a 51% share at the end of the Second Plan, the share of industry rose to 61 5 per cent in March 1965 While percentage share of industry in Bank advances has thus increased in recent years, the share of commerce, financial institutions and agriculture has slightly declined The share of the commercial sector in bank advances in 1955 was 50 per cent, while that of the industrial sector was only 34 per cent The share of the former declined to 32 8 per cent in 1960 and to 25 6% in 1965, but that of the latter rose up to 47 4 per cent in 1960 and to 61 5% in March 1965 Financial sector took up 6 6 per cent share in bank advances in 1960, but 4 5 per cent only in 1965 Similarly, the share of agriculture declined from 1 7 per cent in 1960 to 0 2 per cent in March 1965 only

Scheduled banks' advances rose from Rs 1126 crores to Rs 2095 crores, a rise of Rs 969 crores or 86% over a period of 5 years (1960 65) Of the increase, the major part was on account of advances to industry, which rose by Rs 754 crores or 141% Since the average annual rise in industrial advances during the 5 years (1960 65) was above that in the bank credit in these years, the share of industry in total advances rose from 47% to 62% From this point of view, the rise in industrial advances constituted 78% of the total rise in advances The fact that industrial advances at the end of March 1965 were distributed among only 48,000 borrowers'

1 Reserve Bank of India Bulletin January 1966

accounts out of a total of more than 11,00,000 accounts, is an indication of the large average size of industrial advances as such.[1]

Industries assisted. The industrial advances in March 1965 amounted to Rs 1287 crores. The distribution of this amount among 18 important industries is shown below. The three important industries, viz., cotton (ginning, pressing, spinning and weaving), engineering (heavy and light) and sugar are responsible for about 51% of the industrial advances. The engineering industry alone is responsible for 24%, cotton for 19% and sugar (including gur) for about 8%. Other important industries getting bank assistance are jute textiles (5%), plantations (4.2%), chemicals (3.2%), iron and steel (3.0%), vegetable oils (2.3%), public utilities (3.3%), mining (2.6%), paper (2.5%) and rayon (2.2%). These 12 industries took up as much as 79% of the advances.

Advances of scheduled banks to industry

(Rupees in crores)

	Industry	Dec 1955 Rs	%	April 1961 Rs	%	March 1965[2] Rs	%
1	Cotton	49.7	22.5	145.08	21.2	247.24	19.2
2	Engineering	31.1	14.1	109.62	16.0	304.49	23.7
3	Sugar & Gur	25.3	11.5	100.79	14.7	100.67	7.8
4	Iron & Steel	7.1	3.2	33.90	5.0	39.54	3.0
5	Plantations	—	—	32.90	4.8	54.31	4.2
6	Chemicals, etc	9.7	4.4	33.01	4.8	41.13	3.2
7	Jute textiles	14.5	6.6	32.08	4.7	66.10	5.1
8	Vegetable oils	11.3	5.1	27.44	4.0	28.50	2.3
9	Public utilities	10.6	4.8	26.62	3.8	42.39	3.3
10	Cement	4.0	1.8	18.53	2.7	21.87	1.7
11	Paper	—	—	14.09	2.1	32.06	2.5
12	Mining and Quarrying	6.8	3.1	12.62	1.8	34.21	2.6
13	Drugs and Pharmaceuticals	—	—	—	—	22.50	1.7
14	Rayon, Nylon & Silk textiles	—	—	10.56	1.5	29.25	2.2
15	Other textiles	15.4	7.0	9.44	1.4	27.72	2.1
16	Rubber products	—	—	6.88	1.0	18.36	1.4
17	Fuel oil	—	—	5.09	0.7	28.76	2.2
18	Leather & leather goods	—	—	2.86	0.4	5.10	0.2
19	Others	35.4	16.0	51.35 12.77	7.6 1.8	142.12	11.6
	Total	221.0	100	685.63	100	1287.32	100

[1] *Commerce* dated 26-2-66
Reserve Bank of India Bulletin, January 1966

The engineering group of industries include both heavy and light engineering, the latter getting greater proportion of bank advances The important industries of the light engineering group getting advantage of bank finance are automobiles, wire and wire products and bicycles Out of 10,319 bank accounts of engineering industries as on 31st March, 1965, as many as 8444 were those of light engineering industries If the number of accounts is taken as a guide, the share of engineering industry is the largest followed by cotton textiles, public utilities and plantations as shown below

Number of bank accounts of selected industries as on 31st March 1965

	Industry		*Number of Accounts*
1	Engineering		
	Heavy Engineering	1,875	
	Light Engineering	8,444	10,319
2.	Cotton Textiles		5,757
3	Vegetable Oil crushing and refining (including vanaspati, soap, etc)		2,297
4	Public Utilities (e g., transport, communications, gas, electricity, etc)		3,631
5	Textiles other than Cotton, Rayon, Silk and Nylon		1,868
6	Plantations		3,290
7	Chemicals, Drugs and Fertilizers		1,892
8	Rayon, Nylon and Silk textiles		1,530
9	Sugar and Gur		520
10	Others		17,224
	Total		48,328

The rise in industrial advances in recent years has been shared by all important sectors of industry, particularly engineering, cotton textiles and sugar The relative percentage share of engineering industry in total bank advances (to all sectors of the economy) rose from 4 8 in December 1955 to 8 4 in April 1961 and 14 5 in March 1965, almost a threefold increase The reason is the coming into production of new industrial units set up during the Second and Third Plans as well as a significant growth in the scale of production of many units. The percentage share of sugar industry in total bank advances went up from 3 9 in December 1955 to 7 7 in April 1961, but declined to 4 8 in March 1965 Other important industries taking a large share of bank advances during 1955–65 are cotton and jute textiles, iron and steel, chemicals and paper The following table shows the relative shares of different industries

Percentage share of industries in total bank advances

	Industry	*Dec 1954*	*Dec 1955*	*April 1960*	*April 1961*	*March 1965*
1	Cotton Textiles	10.6	7.7	11.0	11.1	11.8
2	Engineering	3.9	4.8	7.7	8.4	14.5
3	Sugar and Gur	2.4	3.9	6.8	7.7	4.8
4	Iron and Steel	1.0	1.1	2.2	2.6	1.9
5	Plantation	—	—	1.6	2.6	2.6
6	Chemicals	1.6	1.5	2.3	2.5	2.0
7	Jute Textiles	2.4	2.3	2.2	2.5	3.2
8	Vegetable Oils	1.6	1.8	1.9	2.1	1.7
9	Public Utilities	1.2	1.7	2.0	2.0	2.0
10	Cement	0.2	0.6	1.3	1.4	1.0
11	Paper	—	—	1.0	1.1	1.5
12	Mining	0.8	1.1	1.1	1.0	1.6
13	Electrical Goods	—	—	0.7	1.0	—
14	Rayon	—	—	0.7	0.8	1.4
15	Fuel Oil	—	—	0.3	0.4	1.4
16	Leather	—	—	0.3	0.2	0.2

It will be observed from the above figures that certain new industries have come into prominence as participants of bank advances in recent years viz plantations, paper and paper products, rayon nylon and silk, fuel oil and leather and leather goods. The relative share in bank advances of jute, vegetable oils, public utilities and coal mining, etc., has not substantially changed in recent years.

Basic principles of bank-lending

Another weighty financial consideration before a lending bank is the safety of the money advanced. Safety implies safe custody and safe return. The bank advancing money must make sure that the borrower will be able to repay the loan from reasonable safe sources within the agreed period of time. Safety is determined by the degree of confidence in the borrower. In fact, confidence is the basis of all credit transactions. No banker would ever be willing to advance a loan, unless he has sufficient confidence in the borrower about the payment of interest and the repayment of the principal. Confidence of a banker is earned by character and therefore the fundamental principles governing credit are character, capacity and capital which are known as three C's of credit. Instead of the three C's some authors call them as the three R's, i.e., reliability, responsibility and resources. If looked at closely it will be clear that these features are not quite unrelated. A person whose character and capacity are good, is likely to have some capital as well.

Character of the borrower indicates his intention to repay the loan, whereas his capacity and capital are the factors upon which depends his ability to repay the money advanced. If a person's integrity is known to be questionable, the banker will avoid him,

even when he wants accommodation against a collateral security, because it may later on transpire that his title to the security deposited is defective in one respect or another 'Honesty' alone does not constitute character There are several other factors, for example, "the sobriety, the promptness of payment, good habits, personality, the ability and the willingness to carry a project through from beginning to end and the reputation of the people with whom he deals which go to make the character of a customer"[1] A man of character is more creditworthy than a man of property with all its uncertainties and with all the attendant evils like false valuation, misrepresentation and malpractices

With the impersonal relationship that has come to exist in modern large scale business the importance of the other two C's—capacity and capital—has increased a great deal The former is closely connected with the success or failure of a business If a customer has no insight into the particular business for which he wants to borrow funds from the banker, there are greater chances of loss than of 'profit' to the banker It is unwise to share with an inexperienced borrower, the risks entailed in entering into a new line of which he knows nothing There cannot be any absolute certainty about the success of a business and in case there is a loss, the customer's capital should enable him to meet the loss without shifting it to his creditors Hence the importance of the third C (capital) Some borrowers want their bankers to provide most of the capital required This is certainly not the business of the commercial banks but that of the proprietors of the business or credit institutions specializing in long term loans If a customer is in possession of any two of the three C s to a sufficient degree and is deficient to a small extent as regards the third, the banker may not mind extending credit to him

Classification of bank advances

It is probably on the basis of the degree of confidence that Section 20 of the Banking Companies Act classifies the bank advances as (i) *secured*, and (ii) *unsecured* An unsecured loan is one for which the banker has to rely upon the personal security of the borrower The chief basis of such transactions is the personal credit of the customer When the banker has full confidence and unshakable belief in the honesty and the integrity of the customer, such advances emanate They are also termed as clean advances since no formalities of pledge, etc , are needed in this case Unsecured advances are not popular in India Most of the advances granted by banks in India are generally secured ones They have a backing either of a personal security or of an impersonal one Personal security is an undertaking by some third person to be responsible for the repayment of an advance and may take the form of a guarantee under hand or under seal, or a bond under seal, or a promissory note In all such cases, the remedy of the banker is a personal one, i e ,

[1] M L. Tannan *Banking Law and Practice in India* 1954, p 260

if the undertaking is not fulfilled and the advance is not repaid, the banker must take action to enforce his rights against the person who signed the undertaking In India the banker accepts promissory notes with a second signature, i e , endorsed by shroffs, or managing agents of companies Even the Hundi is in effect a two-*name paper* The second category of secured advances has a backing of some tangible and marketable securities, lodged or pledged with the lender, such as bonds, shares, merchandise, immovable property, life policies, title deeds, etc

It may be noted that a major part of the bank advances in India is secured and only a small proportion of about 11% to 16% advances is unsecured as shown below

Secured and unsecured advances of scheduled banks

(Rupess in crores)

Date	Secured Amount	Secured %	Unsecured Amount	Unsecured %	Total
31-12-54	467 2	83 9	89 7	16 1	557 0
31-12-55	543 1	84 2	101 9	15 8	664 9
31-12-60	1004 0	88 8	126 0	11 2	1130 0
29-10-65	1741 8	86 3	276 7	13 7	2018 5

It may further be noted from the above figures that the relative proportion of secured advances has gone up in recent years and that of unsecured advances has gone down In 1954 and 1955, secured advances were about 84% which went up to about 89% in 1960 On the other hand the percentage of unsecured advances fell from about 16 to 11 only during the same period

This trend is in consonance with the progressive growth of joint-stock enterprise in recent years on account of industrial bias given to the country's economy since the Second Five Year Plan As a natural consequence of the growth of joint-stock form of business, the number of company borrowers has gone up and now about 83% of the bank advances are taken up by limited companies, where the relationship between the borrower and the lending bank is less personal than it is in the case of partnership or proprietory concerns and banks The following analysis of bank advances supports this statement

Industrial advances of scheduled banks according to type of borrowers

(Rupees in crores)

Type of Borrower	April 1960 Amount	April 1960 %	March 1965 Amount	March 1965 %
1 Limited companies	440	82 4	1066	82 8
2 State owned and state managed industries	17	3 1	56	4 4
3 Partnership and others	77	14 5	165	12·8
Total	534	100	1287	100

Types of security

Secured loans and advances form 85% to 90% of the total loans and advances in India[1] The security given for the advances is classified as follows

(1) Government and other trustee securities ,
(2) Gold and silver bullion
(3) Gold and silver ornaments ,
(4) Shares of joint stock companies
(5) Merchandise ,
(6) Real estate ,
(7) Fixed deposits
(8) Miscellaneous

Since a large part of the bank advances is taken up by limited companies, usually the manufacturing concerns, it is but natural that the most important securities offered are manufactures, minerals and industrial raw materials as shown below

Statement showing advances of scheduled banks against principal types of securities

(Rupees in crores)

	Types of security	*25 10-63*	*30-10-64*	*29-10-65*
I	Food Articles	49 04	39 21	107 91
II	Industrial Raw Materials	99 69	109 88	117 36
III	Plantation Products	55 61	62 44	71 15
IV.	Manufactures and Minerals	571 97	695 59	842 05
V	Other Securities	437 37	519 27	603 34
	Total	*1213 68*	*1426 39*	*1741 81*

Food articles include paddy, rice, wheat, gram, sugar and gur, vegetable oils and vanaspati, etc , and are offered as security against advances by rice mills, flour mills, sugar factories, oil mills and vanaspati factories Industrial raw materials (item II) which serve as security for loans are groundnuts and other oil seeds, raw cotton, raw jute and hides and skins , they are offered to banks by oil mills, cotton textile mills, jute and leather concerns The tea, coffee, cashewnut and paper plantations take advances from banks on the basis of their own products The manufacturing industries, viz., cotton textiles, jute textiles, iron and steel, mining concerns, chemicals, etc , mostly offer their finished products as security for loans. Other securities include real estate, gold and silver, shares and debentures, Government and other trustee securities, etc Advances are also granted to a small extent against warehouse receipts covering principal types of commodities, viz., paddy and rice, wheat, sugar, cotton, oilseeds, jute, etc

1 Nalinkumar I Almaula *Operations of the Reserve Bank of India* (1936-54 , 1960, p 30

Collateral Security—Mention may also be made of the much spoken term *Collateral Security* In general, the term applies to all types of *security that run side by side with the banker's personal right of action against a debtor customer* in respect of an advance, i e, it applies to share certificates, bearer bonds, title deeds, life policies, etc, deposited by the customer as cover for an advance, and also to *a guarantee or other security signed or deposited by a third party as security* for the customer's overdraft In another sense, the term 'collateral security' is applied to *any of two or more securities that cover the same debt*, as where the account of one customer is secured by two guarantees, or by a guarantee and documents of title

Collateral security (apart from guarantees and bonds) may become available to a banker in one of *four main ways* (a) Mortgage, (b) Pledge, (c) Hypothecation, (d) Lien The first three of these are evidenced by an instrument containing the charge, the reason for it, the amount of the advance and other relevant particulars

Guarantee—A guarantee is a contract whereby one person, the *guarantor or surety*, undertakes to be answerable for the payment of a debt or the performance of some act by another person, *the principal debtor* Section 126 of the Indian Contract Act defines a contract of guarantee as 'a contract to perform the promise, or discharge the liability of a third person in case of his default" The contract of guarantee is therefore a secondary one, the guarantor being liable only if the principal debtor defaults A guarantee may be either oral or written A guarantor who fulfils his obligation and pays the creditor may sue the principal debtor for repayment

When banker's advances are not secured by means of collateral securities and the personal security of the borrower is inadequate, guarantees play an important part The need for this form of security arises not only when an applicant for loan cannot offer any tangible security, but also when the banker finds that the position of the customer indebted to him has weakened as a result of the depreciation in the value of the collateral security deposited, thus leaving the banker's advance inadequately secured A private company may be unable to offer adequate security to cover an advance needed by it but its directors who control the company may be prepared to offer their personal guarantees to secure the loan *The most important form in which bankers give accommodation without any collateral security, is the discounting of clean bills*

Guarantees may be specific or continuing A specific or non-continuing guarantee is one in which the surety undertakes to be *liable only in respect of a specific transaction or a fixed advance* Such a guarantee cannot be revoked by the surety until the loan is repaid A continuing guarantee is one in which the guarantor undertakes to be liable for the balance *at any time owing* on the debtor's account during the continuance of the guarantee up to any limit that may be specified This form is used whether the advance is taken as a fluctuating overdraft or on loan account

Mortgage—A mortgage (other than a mortgage of land) is a conveyance of the legal ownership of the thing mortgaged to the lender, the possession of that thing in some cases remaining with the borrower and in other cases passing to the lender Whether or not a transfer amounts to a mortgage will depend on the language of the documents creating the same In conveyancing, the formula is as follows "The mortgagor hereby conveys, transfers and assigns unto the mortgagee his right, title and interest in the property to have and to hold the same to the use of the mortgagee subject to the proviso for redemption hereinafter contained"

A Legal Mortgage transfers the ownership (though not necessarily the possession) of the property charged to the mortgagee, and gives him a right to sell the property upon default by the mortgagor in paying the principal or interest The mortgagor is left with his equity of redemption, i e, the right to claim the transfer back of the property on discharging the mortgage

An Equitable Mortgage, which may be created by deposit of title deeds with or without a memorandum, or even by a memorandum of charge without deposit of the deeds, gives the mortgagee only an equitable interest in the property, which, except with the consent of the mortgagor, can be realized only if the mortgagee obtains a power of sale or an order for foreclosure from the court.

Pledge—Pledge means the actual or constructive delivery of goods or securities by a debtor to his creditor to hold as a security for the debt It is an express or implied term of a contract of pledge that the ownership of the security remains vested in the pledger (he who deposits them) The rights of the pledgee (who is in possession of the security) permit him to retain the security until payment of the debt and, in case of default, to realize it. Under Section 172 of the Indian Contract Act, a pledge is defined as a bailment of goods as security for payment of a debt or performance of a promise Delivery is necessary in order to complete a pledge It may be symbolical, as for instance, when the key of a godown in which the goods are kept, or documents of title relating to the goods are delivered. Further there may be delivery even when 'there is no physical change in the possession of the goods In point of law, possession of goods may be changed by agreement without any physical change in their position or in the position of the person who actually holds them." Section 175 of Indian Contract Act provides that if the pledger makes a default in the payment of the debt by the stipulated time, the pledgee has two alternative remedies open to him he may either file a suit for the debt and retain the property pledged as security or he may, after reasonable notice, sell the property.

Hypothecation—The term is strictly used to describe the arrangement whereby one person charges goods to another without delivering either the goods themselves or the documents of title thereto In law, to create a mortgage of movables, appropriate words of transfer and conveyance are necessary and for a pledge,

possession is essential A transaction intended to be a security over chattles, in which there are no words of transfer and where the possession remains with the borrower, will therefore amount to an equitable charge which is generally known as hypothecation The instrument creating the charge is called a letter of Hypothecation It is a document of charge by which a customer pledges documents of title with a banker as security It authorizes the banker to deal with the goods in any way necessary, to insure and store them in his own name at the customer's expenses, to pay freight thereon to the customer's debit, to sell them if he deems fit, and to apply the proceeds in repayment of any advance or payment made by him on behalf of the pledger Should the amount so realized be insufficient to satisfy the banker's claims, he still has recourse to the signatory to the letter of hypothecation for the balance due The object of such an authority is to ensure that the banker may be adequately covered in the event of the dishonour of the bills drawn against the goods, or in the event of the failure of the customer to repay the sum advanced

Lien—Lien is the right of one person to retain property in his hands belonging to another until his claims against the owner of the property are satisfied Thus a garage proprietor has a lien on a car in his possession in respect of money due to him by the owner of the car Lien may be either *particular or general* A particular lien confers a right to retain goods in connection with which the *particular* debt arose, whereas a general lien confers a right to retain goods, not only in respect of the debt incurred in connection with them, but also in respect of the *general* balance due by the owner of the goods to the person holding them Bankers have a general lien on all securities deposited with them as bankers by a customer, unless there be an express contract, or circumstances that show an implied contract, inconsistent with lien A banker's lien is *an implied pledge* giving him a right, in case of default, not only to retain but also, after due notice to the customer, to realize securities of the customer and to apply the proceeds in satisfaction of his debt Banker's lien arises mainly over negotiable securities, e g , cheques, bills, notes, bearer bonds and share warrants to bearer Any such securities that come into the banker's hands in the ordinary course of his business as a banker are subject to his lien provided they are not deposited for a special purpose only (e g , safe custody) and that there is no agreement between the banker and his customer that can be regarded as negativing, or being inconsistent with, the banker s right of lien Thus, lien would attach to bills of exchange handed to a banker for collection but probably not to bills lodged to the express purpose of being presented for acceptance Similarly, a banker has no lien on a scrip certificate left bv a customer expressly for the purpose of being exchanged for a bond Banker's lien does not apply to securities specifically charged as cover for an advance because the superior right given by the charge overrides the inferior right of lien [1]

[1] S E Thomas and M Megrah *Principles of Banking*, 1946, p 57

No lien can arise in respect of property that comes into the banker's hands by mistake or to cover a specific advance that is not granted

Bank accommodation or line of credit

Few large manufacturing concerns can go without bank's assistance Every promoter must, therefore, discuss his requirements of finance with his banker, disclose the nature of the raw material and finished products and try to arrive at an arrangement to get enough accommodation from the bank

The arrangement with the bank covers conditions and terms on which accommodation is granted by the bank. The general conditions applicable to a cotton mill are given below[1]

(1) The total advance will not exceed Rs 50 lakhs

(2) The security will be all stocks of cotton yarn and cloth

(3) The amount of advance will be 75% of the market value of the cotton, yarn and piece goods

(4) Where the advance is against hypothecation of the stocks of cotton yarn and cloth, the borrower will always see that there is Rs 100 worth of goods hypothecated for every Rs 75 borrowed by him

(5) All stocks pledged or hypothecated are insured for their full market value with an approved insurance company

(6) Correct statements of goods hypothecated will be furnished to the bank under the signature of a duly authorized person every week. In case of goods pledged, similar statements will be furnished every three months

(7) The bank will have the right to inspect the stock any time at its discretion

(8) Interest on the amounts actually borrowed will be charged at the rate of 2% over the Reserve Bank of India rate with a minimum of 5½% per annum and will be recovered every quarter

Other conditions and more details of the above conditions are found in the printed documents executed by the borrowers in favour of the bank. The banks entrust the borrowers with large amounts and expect utmost accuracy and honesty from them.

Classification of advances

Usual methods of granting accommodation in India are two

(i) Granting advances loans overdrafts and cash credits ,

(ii) Discounting bills hundis and other commercial papers

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1 \ R Sonalker *Industrial Organisation and Industrial Finance*, 1959 pp. 77-78.

(i) ***Cash Credits, Overdrafts and Loans*** Advances by Indian Banks generally take the following three forms (a) Cash Credits, (b) Overdrafts (or demand loans), and (c) Loans

(a) *Cash credit*—Cash credit is an arrangement by which a banker allows his customer to borrow money up to a certain limit against either a bond of credit by one or more sureties, or certain other securities This is the most favourable mode of borrowing by large commercial and industrial concerns in India The advantage is that the customer need not borrow at once the whole of the amount he is likely to require, he can draw such amount as and when actually required He can put back any surplus amount which he may find with him for the time being The banker granting cash credit and overdraft facilities has to estimate the amount of his customer's requirements, and in case the actual drawings fall much below his estimate, he may lose interest on the funds remaining idle In order to provide against such a contingency, generally, banker's cash credit agreement stipulates one-half or one quarter interest clause, according to which the customer has to pay interest at least on one-half or one-quarter of the amount of cash credit allowed to him, even when he does not use that amount Although, in practice, clean loans on personal credit of an individual of undoubted means and character, turn out to be just as safe and satisfactory as any other, yet an Indian banker, partly due to his innate conservatism and partly on account of the tradition established by the old Presidency Banks, insists on having paper with at least two names as security for his advances, as a clean advance on a single name promissory note unsecured by collateral, is looked upon by him as not quite secure

The security offered in case of cash credit is either a commodity, like foodgrains, or manufactured articles The security has to be properly stored in a recognized warehouse or the bank's own warehouse It is the kind of security offered which distinguishes it from overdraft The usual security offered for an overdraft in a financial centre, like Bombay in order of importance, would be stock and shares, Government securities, personal credit, etc [1] Interest charged on cash credit is higher than that charged on overdraft Interest has to be paid only on the actual amount overdrawn and not on the maximum amount permitted to be overdrawn

Every factory, working on a fairly large scale, must have cash credit arrangements with its bank to cover the stocks of raw materials for 3 to 6 months, which it may be required to keep on hand and to take care of the finance that may be required for holding the finished products until they are sold and delivered The arrangement must be large enough also to take care of the company's need for finance if there is a setback in sales

(b) *Overdrafts*—When a customer requires temporary accommodation, he may be allowed to overdraw his current account,

[1] Nalinkumar I Almaula *Operations of the Reserve Bank of India (1935 54)*, 1960, p 31

usually against collateral securities From the customer's point of view this arrangement like the cash credit is advantageous as he is required to pay interest on the amount actually used by him The essential difference between a cash credit and an overdraft is that the latter is supposed to be a form of credit to be made use of occasionally, whereas the former is used for long terms by commercial and industrial concerns doing regular business Overdraft is more suitable for lendings of smaller amounts than in the case of a cash credit The interest charged on overdrafts is lower than that charged on cash credit The rate of interest charged in each case varies according to the financial standing of the customer, and the availability of loanable funds The interest is paid only on the amount overdrawn and not on the maximum limit allowed

Documents taken to secure cash credit and overdrafts should provide for continuing security, i e , the security should not diminish or lapse in case the account is reduced or *brought in credit* Otherwise the documents would not cover any subsequent *debit* entries in the account It is particularly necessary in case of accounts guaranteed by third parties

(c) *Loans*—When a banker makes an advance in a lump sum the whole of which is withdrawn and is supposed to be repaid generally wholly at one time is called a loan If the customer repays the same either wholly or partially and wishes to have accommodation subsequently, the latter will be treated as a separate transaction to be entered into if the bank agrees to do so and subject to such terms as the bank may like to impose Thus the bank does not suffer any loss of interest as a result of carrying excessive cash which is necessary in the case of cash credit and overdrafts Loan accounts are said to have a lower operating cost than cash credits and overdrafts because of the larger number of operations in the case of the latter as compared to the former and consequently a lower rate of interest on loans appears to be justifiable than in the case of overdrafts and cash credits

This is the simplest form of lending Cash credits and overdrafts are invariably used for trade and business, but loans are frequently raised for non trading purposes as well Loans are made for longer periods than overdrafts or cash credits, but rarely extend beyond a year In case of business loans the collaterals used in order of importance are Government securities, real estate, and stocks and shares In case of personal loans, however, the collaterals used are real estate, ornaments, and, very seldom, Government Securities

The amount of loans, cash credits and overdrafts almost doubled during the decade 1951 61 The Indian scheduled banks advanced under this head Rs 533 66 crores in 1950-51 which went up to Rs 1127 74 crores by 1960-61 The upward trend has continued thereafter also The advances of Indian scheduled banks in 1964-65 came to about 80 per cent of their total short term advances

excluding 'money at call and short notice' which represents simply inter-bank dealings The following figures may be of interest

Different types of advances of Scheduled Banks

(Rupees in crores)

Year	*Money at call and short notice*	*Bills purchased and discounted Inland*	*Foreign*	*Total*	*Loans cash credits and overdrafts*	*% share of loans to total deposits*
1	2	3	4	5	6	7
1950-51	—	13 26	—	13 26	533 66	22 1
1955-56	6 31	102 02	46 47	148 49	612 45	73 0
1960-61	20 78	159 35	49 23	208 58	1127 74	75 6
1961-62	37 55	180 69	48 53	229 22	1190 07	73 2
1962-63	38 78	222 56	56 17	278 73	1323 56	77 8
1963-64	36 89	231 31	65 00	296 31	1537 32	79 5
1964-65	36 76	262 65	74 07	336 72	1722 38	78 8

It will be seen from the above figures that bank advances in the form of loans, cash credits and overdrafts have increased in absolute terms as well as in relative terms in recent years considerably Their relative percentage in total bank investments has gone up from 80 4 in 1955-56 to about 84 4 in 1960 61 and to 83 6 in 1964-65 In arriving at the above percentage the amount of column 2 (i e , money at call and short notice) has been excluded as it represents mostly inter-bank dealings and does not come in the category of industrial loans or advances

Money at call and short notice—The call money market is almost entirely confined to inter-bank dealings Other institutions and individuals sometimes enter the market as lenders The call money market is more active in Bombay than in Calcutta In Madras it is insignificant In all the three centres the Exchange Banks are the main borrowers In Ahmedabad a call money market also operates among groups of private traders who lend and borrow amongst themselves overnight loans at an agreed rate of interest The scale of operations, however, is not significant

Call loans enable banks to employ their surplus funds profitably for very short periods of time like a day or two Call-loans arise because of the surplus funds left with the banks Large variations in the amount of the surplus funds occur according to the seasonal stringency or slackness The only alternative to call loans is to have idle cash or to invest the surplus funds in advances to customers and in the Government Securities, which on the average earn much less than demand loans (overdrafts) During the slack season when there is a surplus of funds, the call loans are based on the idea that some return is better than no return and that the banks could recall the loans when the busy seasons returns As already stated, the Exchange Banks are the main borrowers Their investments are

highly liquid and include a large portfolio of bills and, therefore, their cash reserves are rather low compared to those of other Indian banks But they have a high reputation and therefore, can borrow in the market whenever they need cash, even though they have low reserves When the amount of bills offered exceeds the amount of bills maturing, temporary stringencies arise for them They tide over this stringency by borrowing money from the other banks at call or short notice in the market In addition, such borrowings are the means of mobilizing funds and employing economically such money as is available at the height of busy season

Unlike call-loans in London, which are secured by collateral in India inter-bank call-loans are unsecured

(ii) ***Discounting of Bills*** The most important form in which bankers give accommodation without any collateral security, is the discounting of clean bills This form of employment of a substantial part of the banker's funds is very popular with the commercial banks in the leading European countries India's commercial banks do not employ their funds in the discounting of bills to the same extent as do the European banks though there has been some improvement in this direction in recent years, particularly since the introduction in 1952 of the Bill Market Scheme by the Reserve Bank of India The reason for the unpopularity of bills with Indian Banks is the lack of liquid resources to the same extent as their conferers in England have, because most of the deposits of banks in India are not payable on demand or at very short notice Moreover the yield from Government securities is usually higher in India than in England

In 1951 the Indian Scheduled Banks purchased bills to the extent of Rs 15 6 crores only The amount employed by these banks in discounting bills rose to Rs 38 8 crores in 1952 when the Reserve Banks' scheme was introduced Since then Indian Banks have made an increasing use of this system of employment of their funds, so that in 1955 the amount employed was Rs 105 9 crores which rose to a peak figure of Rs 171 3 crores in 1957 In the next two years the amount declined considerably, but again showed an upward trend having reached Rs 157 5 crores in 1960 This is about 14% of the total short term investments of scheduled banks Out of Rs 157 5 crores spent on purchasing bills of exchange in 1960, Rs 110 9 crores were spent on inland bills and Rs 46 6 crores on foreign bills

Advantages of discounting of bills.[1] Discounting of bills is advantageous to commercial banks in many ways

(1) ***Certainty of payment on due date*** The money invested in first class bills is realized on the due date The first reason is that the businessman who has accepted a bill endeavours to honour it, as otherwise his credit suffers The second reason is, if the acceptor fails to make the payment on the maturity of the bill, the banker

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1 M L Tannan *Banking Law and Practice in India*, 1954 pp 275 76

will get his money from his customer, the drawer or one of the endorsers more particularly the customer for whom he discounted the bill

(2) ***Employment of funds for a definite period*** The banker is able to employ his funds for a definite period and by judicious selection of the maturities of the bills he can so arrange his investments as to enable him to meet all his foreseen demands without keeping his funds idle for any time

(3) ***Liquidity*** *These bills constitute securities of a very* liquid nature and can be used for strengthening his cash reserve In *case of urgent or unforeseen demands, the banker can convert bills* into cash by getting them rediscounted with the Reserve Bank of India Thus, a bank *with a very large part of its funds in bills can* do with comparatively smaller cash reserves than those with smaller bill *portfolio*

(4) ***Freedom from fluctuations in prices*** Commercial bills *are not subject to price fluctuations like the stock exchange securities* and are therefore advantageous to bankers

(5) ***Higher yield*** The yield from the discounting of bills is slightly higher than that from loans or advances, because in the case of the former, the interest known as discount, is deducted at the time of discounting the bills, whereas in the later case, it becomes payable only when the principal falls due or is payable *quarterly*, half yearly or yearly If a banker invests Rs 1 crore in discounting *bills for 3 months at 5%, and another banker invests an equal amount* in loans for the same period and at the same rate, the former is able *to earn about Rs 6,600, i e, 25% more than the latter The return* per cent per annum is shown in the following table in both the cases

By Interest %	By Discount %
5	5 2631
6	6 3829
7	7 5268
8	8 6956
9	9 8901
10	11 1111

(6) ***New Accounts*** Banks discounting bills are able to attract more customers, because parties who have to make payments of bills generally open accounts with banks holding bills drawn upon them

Reasons for the restricted use of bills in India

Even though there is discounting of bills and the system is gaining popularity, there is no true bill market in India Most of the bills that are discounted by banks are held till maturity and in case of export bills they are discounted in the London money market by the Exchange Banks because they have an easy access to that market and it is also said to be economical for them The chief reasons for the restricted use of bills in India are .

(1) ***No direct link between the Reserve Bank and the Indigenous Banker*** In the unorganized sector of the money market the lack of the development of broadly based hundi market could be attributed to two important causes One is the absence of any direct link between the Reserve Bank and the indigenous bankers. This means that the indigenous bankers could not rediscount the hundis in their portfolio with the Reserve Bank when they need more cash Second is the refusal of the Reserve Bank to recognize hundi as equal to a bill of exchange in the conventional sense of the real bill doctrine

(2) ***No homogeneity of customs governing hundis*** The lack of uniformity in the customs governing the hundis is another reason for the relative unpopularity of commercial bills in India. If the hundis were drawn in a single language without the long prefatory salutations and unnecessary greetings and with their essential features definitely defined they would circulate more freely than they do at present

(3) ***The system of Cash Credits and running Accounts*** The basic reason for the failure of an active bill market is the preference of businessmen in India for instruments of credit other than bills of exchange They prefer advances in the form of cash credits and overdrafts from banks to discounting bills of exchange for financing their business needs The popularity of advances over bills is proved by the fact that the ratio of bills discounted to advances among the assets of scheduled banks is usually very low It varies between three and five per cent. The reason for the popularity of cash credits and overdrafts is that they are more convenient and inexpensive compared to bills In the case of cash credits, interest is paid only to the extent that credits are used with half or quarter interest clause and the bank can withdraw credits in the event of any deterioration in the position of the borrowing party The commercial banks too prefer loans and advances from the Reserve Bank to rediscounting bills with it.

(4) ***Lack of facilities for rediscounting*** Before the Reserve Bank of India was started the Indian joint-stock banks, in case of need had to resort to the Imperial Bank of India for financial assistance and as the latter competed with the former in commercial banking business the joint stock banks preferred to make use of their Government securities portfolio for loans from the then central banking institution instead of getting their bills rediscounted by it so as to avoid disclosing the names of their clients whose bills they had discounted. Moreover, the facility of rediscounting was restricted to approved bills only

(5) ***Absence of public warehouses*** There being lack of public warehouses and godowns in India for stocking produce the documentary bills, which would be more popular with Indian joint stock banks are conspicuous by their absence.

(6) ***Small number of bank offices*** The absence of a sufficient number of banking offices in the country also accounts for

the lack of popularity of bills of exchange. If goods are sent from port towns to upcountry places with no banking facilities the charges for the collection of bills drawn in connection with such consignments entail a heavy burden. Moreover, this factor also stands in the way of ascertaining the credit position of parties in comparatively small places.

(7) ***The evolution of branch banking.*** The growth of branch banking and the use of telegraphic transfers obviates the need for financing trade transactions by means of bills of exchange. To this cause may be added the improvement in means of transportation which makes possible the quick transfer of goods from one place to another, and to that extent reduces the period for which credit is required for a transaction.

(8) ***Stamp duty.*** The high rate of stamp duty on bills in India is also a great handicap to the free use of commercial bills.

Bill Market Scheme

The banking authorities in India have been trying for a long time to establish a discount market on the British model. The Reserve Bank of India since its inception has directed its attention in this direction. The Reserve Bank directed its efforts in two directions. Firstly, it tried to develop a direct link between itself and the unorganized sector. The essence of this effort was an offer to rediscount *hundis* of approved indigenous bankers, provided they agreed to accept certain conditions advanced by it. Its efforts, however, failed to make any headway.

Secondly, it attempted to develop the habit of rediscounting bills in the organized sector both among the scheduled banks and the co-operative banks. It developed two schemes for the organized sector: one for the co-operative banks and another for scheduled banks. In both schemes it has been successful particulary in *the bill market scheme for scheduled banks.*

To promote the habit of dealing in bills and rediscounting them, among the scheduled banks the Reserve Bank made a beginning with treasury bills. It is true that treasury bills are entirely different from commercial bills in purpose and contents. But at the time they were the only assets approaching bills of exchange and were available in sufficient amount (excluding *hundis*). The treasury bills were discounted by the scheduled banks with the Reserve Bank regularly and in substantial amounts.

Though the value of bills discounted by the scheduled banks nearly doubled during the war period, yet it reflected more the wartime inflation of prices than an increase in the popularity of the use of bills of exchange. The idea of developing a bill market received new impetus during the Korean War boom. In late 1951 the Reserve Bank was faced with a new monetary situation. A credit inflation of serious proportions had occurred and the Reserve Bank was faced with the problem of establishing its control over bank credit. It may be recalled that to check this new inflation the

Reserve Bank raised its bank rate from 3% to 3½%, and made a break with its long established policy of buying and selling Government securities at the initiative of the commercial banks. With this break, an alternative means of introducing an element of credit elasticity in the money market had to be found. The Reserve Bank found the answer in a bill market. A bill of exchange would provide the necessary credit elasticity to the money market. The supply of bills could be increased during the busy season and decreased during the slack, as the maturing bills would be liquidated to suit the decreased need of the market. Therefore after consultations with the leading bankers of the country the Reserve Bank announced in January 1952 *a scheme for the creation of a bill market*.

Under this scheme the Reserve Bank announced its readiness to make demand loans to scheduled banks against the security of their demand promissory notes supported by usance promissory notes of their constituents. As an inducement to banks to popularize the bill as an instrument of credit, the Bank offered to make such advances *at ½ per cent below the bank rate and to bear half* the cost of the stamp duty incurred in converting demand bills into time bills. The maximum value of individual bills tendered to the Bank was fixed at Rs 1 lakh and the minimum limit for a single advance at a time at Rs 25 lakhs. The scheme was originally restricted to scheduled banks with deposits of Rs 10 crores as on December 1951, but has since been extended to scheduled banks with total deposits of Rs 5 crores and over.

From the very beginning the scheme showed signs of success. Within the first three months of its operation the amount of advances under it reached a figure of Rs 28 crores.

The facilities available under the scheme have been progressively liberalized as its working demonstrated the need for it. The Indian Banks' Association represented to the Reserve Bank that the eligibility requirements fixed initially were too restrictive and, consequently, very few banks could take advantage of the scheme. Therefore, it was decided in June 1953 to extend facilities under the scheme to scheduled banks having deposits (including deposits outside India) of Rs 5 crores or more, provided they were in possession of a licence granted by the Reserve Bank as required by the Banking Companies Act. It was further decided, for a period of one year in the first instance, commencing from *October 1, 1953*, to refund such cost of the stamp duty as was in excess of one anna per thousand rupees, instead of half the cost of the stamp duty as originally provided for in the scheme. In 1954 the Reserve Bank decided to extend the facilities under the scheme to all scheduled banks in possession of a licence from it, irrespective of the size of their deposits. It was also decided to lower the minimum limit of advances under the scheme from Rs 25 lakhs to Rs 10 lakhs and the minimum amount for each individual bill from Rs 1 lakh to Rs 50 000. These limits for each advance and each bill were further reduced by stages to Rs 1 lakh and Rs 10,000 respectively in October 1959.

Since 1955 exchange banks began to evince considerable interest in the Bill Market Scheme. Since 1959 it has been decided to extend facilities under the scheme during the slack season only to such banks as had taken advances in the earlier busy season and to restrict the relative credit limits to each of them to the maximum amount of its borrowing during the earlier busy season. This is intended to reinforce the restraining influence of the other measures, having regard to the pattern of utilization of facilities under the Bill Market Scheme. The Reserve Bank operates its general credit control in a flexible manner so as to meet the credit needs of specific sectors. The Bank agreed in 1961-62 to sanction larger limits to banks under the Bill Market Scheme on bills by sugar and jute mills so as to enable them to meet the special difficulties of sugar and jute mills. Similarly, with a view to encouraging banks to afford increased assistance to small-scale industries and the co-operative sector, the basic quota allowed to each bank for borrowings at the Bank rate was enhanced since January 1962 by an amount equivalent to the increase in the average of their loans to small-scale industries and co-operative institutions, in the first half of 1961 over the corresponding period of 1960. Thus, the scheme is gaining popularity and its introduction by the Reserve Bank has been a step in the right direction in the Bank's efforts to provide elastic credit through the development of a bill market.

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Determination of Income

The basic principle with regard to income is that it originates in the market place meaning thereby that it begins with an exchange To express the idea in simple words it can be said that only a sale can produce income In this sense the income is flowing into the business throughout the year and is being recorded as the flow of *realized* values into the concern Broadly speaking the income as it flows into the concern from day to day it gets mixed up in the *circuit flow of current assets according to the day to-day decision* taken by the people concerned with the administration and management of the concern The realized values enter into the circuit flow of current assets in the form of payments for raw materials, wages and other expenses In the broad and real sense of the term management *of income applies to these day to day decisions of the management by* which the realized values are put to various uses in running the business with a view to earn a profit In the narrow sense the term is applied to the computation and appropriation of the gross or net income at the end of an accounting period, usually a year The surplus or profit is determined and decisions are taken with regard to its disposal for creating reserves or for payments of dividends In this sense income is a monetary expression representing an increase in wealth accruing to the owners of the business during a given period (usually a year) resulting from the employment of capital or the rendering of services Gross income is the fruition of money (or the equivalent of money), affected within the period of all those elementary services which are the components of enterprise operations When the goods are sold for cash the fruition is in money but when they are sold on credit the fruition is in equivalent of money payable after the usual period of credit Net *income is* obtained by deducting costs of production, other operating expenses interest, depreciation etc , from the gross income

The gross and net income may not denote the same things in the accounts of all enterprises and in all countries The practices of calculating the income and the methods adopted for the purpose by different enterprises may differ from each other *according to* the

policies of income reporting followed by those responsible for the administration and management of enterprises or according to the purposes for which the income is being calculated The method adopted for calculating the income for tax purposes may differ from the method adopted for finding out the income for amalgamation

In India the procedure of computing the profit and loss of the joint stock companies has been laid down by law in detail The requirements of law governing the profit and loss account of a company are given in Part II of Schedule VI attached to the Companies Act 1956 The profit and loss account has to show clearly the various items relating to income and expenditure of the company arranged under most convenient heads and it has to disclose separately the information required by law The profit and loss account is to be made out in such a way as to disclose clearly the result of the working of the company during the accounting period The income side of the profit and loss account has to show (1) the turnover (total sales less the amount of goods returned, price adjustments and trade discounts), (2) investment income, (3) income by way of other interest, (4) profit on sale of investments, (5) dividends from subsidiary companies, (6) miscellaneous income like transfer fees, rents, etc , (7) closing stocks of raw materials, work-in-progress and finished goods (to be given separately) (8) amounts withdrawn from reserves and provisions previously made, and (9) extraneous profits arising from abnormal, exceptional or non-recurring transactions, and from a change in the basis of accounting (e g , a change in the methods of stock valuation or in the method of calculating depreciation)

The expenditure side of the profit and loss account has to show (1) stocks and purchases of raw materials in the case of a manufacturing company or of saleable goods in the case of a trading company, (2) stores, and power and fuel consumed, (3) employees' remuneration and benefits, (4) repairs, (5) selling expenses, (6) interest on long term borrowings, (7) other expenses (rent, rates etc), (8) depreciation, (9) taxes on income, (10) loss on the sale of investments, (11) donations, (12) extraneous losses (losses from abnormal or non-recurring transactions or from a change in the basis of accounting), (13) transfers to reserves, (14) other provisions, (15) payments of remuneration, commission, allowances, pensions, etc , to managements, (16) payments to auditors, (17) payment of previous years' (unpaid) expenditure, and (18) dividends

The form in which the profit and loss account is to be prepared is not indicated in Part II of Schedule VI But usually it is prepared in two parts the first part may be termed as the profit and loss account *containing the items relating to all types of income and the* items of expenditure chargeable to income ; the second part may be termed as the appropriation account showing the appropriation of net profit for purposes of reserves and dividends

The law has laid down the detailed information which has to be disclosed in the profit and loss account along with the major heads under which the different items are to be grouped. This

arrangement is helpful to the shareholders in understanding the process of *determining the profits as well as the nature of the* expenses charged against the income In course of time numerous abuses had crept into the managing agency system and a very substantial portion of the earnings of the companies was being appropriated by them for themselves by adopting various dubious methods without disclosing different types of charges separately in the final accounts This is no longer possible now as most of the items of expenditure subject to corrupt practices and questionable methods of charging are now required to be stated separately under distinctive heads e g , the interest on long term borrowings (debentures and fixed long term loans) and payments to management are required to be shown in sufficient detail prescribed by law to indicate clearly the nature of payments to management

The government has succeeded in compelling the managements to place before the shareholders a detailed information with regard *to the various items of income and expenditure* to enable *them* to understand clearly the sources from which the income has been *derived and the nature of the various items of expenditure which have* been charged against income

But the type of profit and loss account which is being prepared in compliance with the requirements of Company Law is not very helpful for managerial and administrative purposes This is because the account is not required to be prepared in a manner so as to show the gross and net income, operating and non-operating income operating and non-operating expenses, fixed and variable charges, step by step and stage by stage beginning with the gross income from sales and ending with surplus to be carried to the next accounting period This type of information and analysis is very essential for the purpose of comparison of gross and net income, operating and non-operating expenses, fixed and variable charges with similar items of previous accounting periods by reducing the total figures to various types of ratios relating to the capital employed or the volume of sales This type of analysis and comparison really form the basis of very important managerial and administrative decisions for making the necessary changes and adjustments in operating and financial policies and practices to obtain best possible results

The statements required to be furnished to directors and officers in charge of financial management are somewhat different from those required to be presented to the shareholders *in the form of annual* accounts These statements are in sufficient detail so that the given results may be correlated with possible causes These statements may be called the Income Statements or Operating Statements These statements show the various steps *in the analysis and management of* income far more clearly than is done by ordinary profit and loss account *At each step the people responsible for financial management* are faced with questions of policy which are of far greater importance than the questions *of mere accounting practices* *The following* discussion will show that computation of income for each step is the

administration of income Foremost in the minds of the financial administrators is the question of useful employment of income the remaining amounts being secondary considerations A theoretical proforma of an income or operating statement may be given here to facilitate discussion

Income or operating statement

		Rs
1	Gross Income—representing gross sales, gross earnings, or gross operating income	5,00,000
	Deduct	
2	Cost of goods or services and operating and selling expenses	3,00,000
3	Net operating income—representing gross profits or manufacturing profits	2,00,000
	Add	
4	Non-operating and other income—representing dividends or interest on investment	15,000
5	Total operating and non operating income	2,15,000
	Deduct	
6	Fixed charges and non-operating expenses—representing interest on debentures, bonds, amortization, etc	25,000
7	Net operating and non-operating income	1,90,000
	Deduct	
8	Provision for taxes	80,000
9	Net income or profit—representing surplus available for payment of dividends and for being conserved	1,10,000

Gross income in Item No 1 represents the total of all gains realized through operations—the normal processes of manufacture and sales or sales only (in the case of trading concerns) or rendering of services (in the case of public utility concerns) Capital gains or non-operating income is not included in this item By the time this statement is prepared major part of the amount of cash representing gross income must have completed the circuit flow and may have been reinvested in raw materials or wages or may have been used in meeting the obligations of the business like the payments to creditors But some parts of gross income may still be in the form of receivables

The cost of goods or services and operating and selling expenses included in Item No 2 comprising all expenses incurred in obtaining the gross income have to be deducted from this income.

The cost of goods sold may be arrived at by taking the cost of opening stock, adding the costs of materials wages salaries, depreciation charges etc, incurred during the accounting period and deducting the cost of the closing stock. The operating and selling expenses may include general, administrative and selling expenses

The Item No 2 can also be designated simply as "operating expenses" and the expenses comprised therein may be classified as 'variable' and 'fixed' expenses The variable expenses increase or decrease with the changes in the volume of production while the fixed expenses remain more or less constant despite the changes in the volume of output Under variable expenses may be included raw-materials, wages, fuel, power, etc while maintenance, salaries, lighting, rents, etc may be categorized as fixed expenses Variable and fixed expenses may also be called direct and indirect expenses. The percentages or ratios of direct and indirect expenses are of great significance and importance to the financial management for controlling the operating expenses and reducing the costs In calculating operating expenses not only should the accrued and deferred expenses be properly adjusted with regard to materials, wages and other expenses but adequate provisions for reserve for purposes like depreciation, obsolescence, bad debts, taxes etc should also be included as they are to be regarded as expenses in earning the gross income

The amount of net operating income is determined by deducting operating expenses (Item No 2) from the gross income (Item No 1) The amount of net operating income is of great significance to financial administrators regulating authorities of public utility enterprises, and the security analysts, as it represents the real index of the operating efficiency and success of the company or the corporation. Taken over a period of years it gives an accurate idea of the stability or unstability, regularity or irregularity of earnings On the basis of the behaviour of this item over a number of accounting periods financial management takes important decisions with regard to the inclusion or exclusion of different types of securities like the equity and shares, debentures and bonds in the capital structure of the business unit and determines their appropriate proportions. Stability of this item over a time acts as a green signal for the financial management to embark upon a programme of trading on the equity when borrowed capital is readily available in the capital market on favourable terms This amount, properly averaged, represents the figure, which the financial management of a competitive enterprise would use for comparing the efficiency of its performance with other similar enterprises or for judging its own ability to support its own capital structure adequately The management will also watch carefully and closely the behaviour of this item over the business cycle as likely to respond less directly to changes in the size of operating expenses (Item No 2) These observations will affect the choice and the decision of the management to expand their business

The income received from dividends, interests on bonds and notes receivable and from similar other sources which does not result

directly from normal operations is called non-operating income Under the head 'other income' capital gains resulting from the sale of assets or speculative gains obtained from transactions like hedging contracts should not be included

The total of Item Nos 3 and 4 gives the total operating and non-operating income from which the fixed charges and non operating expenses are to be deducted

Item No 6 comprises the expenses which are not directly related to the operations of the company and are therefore usually called non-operating expenses Besides miscellaneous expenses they also include fixed charges which mainly consist of interest on funded debt Interest paid to banks and other current creditors is usually included in this item but some people include the discounts given to customers for prompt payment on the ground that this discount really represents the interest given to the customers for the use of short term funds Interest on long term debt also includes instalments to make up the difference between the face value and selling price of the bonds or debentures if they were sold at a discount Rents on leases are also sometimes included under this head as they represent fixed charges

After deducting the charges included in Item No 6 from item No 5, net operating and non operating income (Item No 7) is obtained After making provision for corporate taxes (Item No 8), the net income or profit (Item No 9) is obtained

The net income or profit can be used either for payment of dividends or for being conserved The payment of a corporate dividend is corporate consumption and what is consumed cannot be recalled however urgently the funds may be needed for some other essential purposes Therefore it becomes very necessary for a corporate unit to review its reserve policy before consuming or spending its net income Even if adequate provision has been made for depreciation, obsolescence, bad debts, etc , at the earlier stages of the operating statement, the advisability of providing for future growth should not be overlooked at this point because the mere fact that the net income is a positive figure or surplus does not warrant that a part of it should not be saved or set aside for future growth and development of the corporation It has to be remembered in this connection that the capital that has been earned is the cheapest capital that a company can employ, cheaper than any that it could raise

After this a decision has to be taken by the management with regard to the declaration of the preference dividend This decision is dependent upon reserve, surplus and expansion policies of the management, although it is advisable to pay the preference dividend first and then decide about the size of reserves, surplus, etc , and the payment of dividend to ordinary, common, or equity shareholders

In the process of determination or computation of income certain types of mistakes are likely to occur Some of them might creep in on account of inaccuracies in the process of accounting

itself but others might be the result of deliberate intention or unsound policy followed by the management

Some of these errors might result in an overstatement of gross income Omissions of sales discounts allowances to customers and prepaid freights will inflate the size of gross income It has to be remembered that rebates and allowances for inferior quality, shortages, breakage spoilage, etc , are deductions from sales income and not additions to operating expenses

The inclusion of unrealized gains in the gross income is also incorrect. For example, the inclusion of the total instalment sales in the gross income, without taking into account the costs of collection and the losses due to defaults in payment is not justified. Even the realized gains resulting from the profit obtained on the sale of some of the items of assets should not be included in the gross income

An understatement of expenses also creates an erroneous impression and leads almost to the same result as an overstatement of gross income Expenses accrued but not paid may be overlooked and not included in the operating expenses Taxes, wages, salaries, advertising charges etc due but not paid during the accounting period should be included in the record of expenses otherwise the net operating income will be overstated. The difficulty in distinguishing clearly between repairs or renewals also sometimes leads to understatement of expenses as major repairs may be treated as renewals and charged to capital account in place of expenses account

Understatement of capital expense is also likely to result if discount on bonds and debentures is not amortized. This will lead to the overstatement of net operating and non-operating income (Item No 7) A niggardly reserve policy is also likely to show larger income than it really is for a correct determination of income. The foregoing points have to be taken into consideration at the time of the preparation of the operating statement.

16

Management of Income

(a) Reserves

Some part of the income is set aside, conserved or reserved at various stages from the time it begins to flow in as gross income as a result of sales of goods and services up to the time of its final appropriation in the form of net profits or net income The reserves begin to appear quite early in the operating statement in the form of amounts set aside for payment in the next accounting period on account of operating expenses like taxes which have fallen due but have not been paid Others like dividend equalization reserve appear towards the end , they are deductions from profit or surplus and not from income Thus the reserves of a concern may be found scattered throughout the operating statement they may be in the operating expenses, among the fixed charges and taxes, or they may appear as deductions or appropriations from net income or profit In the balance sheet the reserves may be found among the assets, the liabilities or the net worth

Some writers define reserves as a predetermination of money values—the values which will not be known before some future date Here the main emphasis is on the uncertainty of the quantum as well as the time of the amounts which are required to be reserved Other writers think that this view is not quite correct because the amount and the time of need of certain types of reserves like the debt retirement sinking fund are both known definitely Reserves, therefore, they say, are required primarily to provide the means or funds for the postponed expenditure Perhaps it may be more appropriate to say that the process of making reserves is an accounting device for reducing the carrying value of an asset, recording a known or contingent liability or appropriating available current profits The reserves may be divided into three classes

(1) *The asset or the valuation reserves*—The values of assets shown in the books are derived from the transactions which were completed in the past and the process of creating the valuation reserves represents an attempt to adjust the values of the past to the

present or the foreseeable future values of the assets These reserves are created by a charge to the income for the current accounting period and are shown as a deduction on the balance sheet from the value of particular assets Valuation reserves may be made in the case of assets like the accounts receivable investments marketable securities, plant, machinery and equipment and intangible assets with a limited life

The accounts of debtors or the accounts receivable are not always realized in full There is a possibility of some of these accounts not being paid and thus becoming bad debts A provision for these estimated losses is made by charging the estimated amount to the income for the period during which the sales were made This provision is called a *reserve for bad debts or an allowance for bad debts.*

Investments in subsidiary companies are usually carried in the books at cost and the marketable securities at the market value or at a lower cost. *But when there appears to be a permanent decline in the value of long-term investments or a significant decline in the value of marketable securities a reserve* is usually made by charging an estimated amount representing the difference between the cost and the current value, to the current income

Physical wear and tear due to operations, decline in usefulness on account of the development of better processes and equipment or exhaustion of properties through extraction bring about a decline in the values of business assets These losses of value are offset by reserving a part of the current income These provisions are usually called depreciation, obsolescence and depletion reserves. In all these cases the reserves are a result of the policy decisions taken during the process of income determination and represent an effort to replace lost value with a gained value

(2) *Liability reserves*—Some of the accrued expenses, taxes, pensions, and contingencies are not definitely known at the end of the accounting period. They are essentially current liabilities which the business owes and intends to pay in the next accounting period. Being current liabilities they cannot properly be classified as reserves. It is advisable, therefore, to include them in the list of liabilities in the balance sheet and avoid the use of the word 'reserve'.

The difference between the asset and liability reserves can be clearly illustrated by taking the example of depreciation and tax reserves The savings from the depreciation deductions may be accumulating for years and when finally the time for the replacement of the asset comes the management might decide to resort to outside financing for this purpose and leave the assets built up from the depreciation fund undisturbed. But the tax reserve will be required to be used for meeting the tax liability in cash in the next accounting period and the working capital has to be managed in such a way so that this expenditure may be met conveniently Thus the asset reserves will not require the paying out of cash immediately whereas in the case of the liability reserves an early expenditure in cash has to be anticipated.

(3) *Net worth or surplus reserves*—These reserves are created out of profits or surplus They represent restrictions on the use of retained earnings, increase the net worth permanently and are a part of the shareholders' equity The creation of these reserves simply means putting up of specific labels on parts of the retained earnings signifying the use for which they are meant Reserves for debt retirement sinking fund, for plant extensions, and for dividend equalization may be cited as examples of these reserves There is a significant difference between the asset and liability reserves on the one hand and the net worth reserves on the other the depreciation reserves or the tax reserves will be expended ultimately or shortly and will be closed when they are used for the purpose for which they were created , but a debt retirement reserve represents a saving and not an expenditure of the income A word about hidden or secret reserves is also necessary They do not appear on the balance sheet although they form part of the net worth They may be created by the management to conceal profits from the eyes of the taxation authorities, the shareholders or the competitors so that less taxes may be paid, lower dividends may be justified or the competitors may be misled The usual methods for creating these reserves are to undervalue the assets by charging excessive depreciation or to put up larger liability reserves than are actually required They may also be created by charging capital expenditure to operational expenses or by carrying stocks at less than their correct value Some of the writers think that these reserves are a distortion and are undesirable unless the business in which they are created is highly speculative But some writers also hold the view that the practice of creating secret reserves, if adopted by conservative managements with good intentions, is a prudent one It cannot, however, be denied that internally created secret reserves amount to accounting manipulation and to rendering of untrue financial statements and may be harmful to the interest of the security-holders as full market value may not be realized by those shareholders who sell their shares in the open market

A good reserve policy is expected to serve two fundamental purposes , first of all it is of vital importance in the determination of net income Truly speaking, a profit can only be said to have been made if the business estate has been kept intact Reserves are mainly created to keep this estate intact Secondly the reserve policy also assists in the administration of the general financial policy Its assistance is specially useful in operational and functional analysis, in providing for uncertainties and in planning for debt retirement Its help in operational or functional analysis may be clearly illustrated by taking one or two examples A scrutiny of the inventory fluctuations reserve will serve as a good guide for analysing the functions of buying and storing Similarly in the case of instalment selling the charges and credits to the reserve for bad debts may be a better index of operational or functional efficiency or inefficiency than the gross or net income or profits With regard to the provision for uncertainties it may be stated at the outset that the costs are of the

past and the values are of the future. Monetary cost is the most convenient method of recording the worth of all the transactions in the books of accounts. Future values will not usually coincide with costs of the past recorded in the books. This discrepancy between the costs of the past and the values of the future gives rise to uncertainties. The reserve policy is directed against these uncertainties which cannot be removed completely but the evil effects of which can surely be modified by a well-conceived and properly executed reserve policy. With regard to the plans for debt retirement it may be stated that so long as the activities of the business are not curtailed or discontinued debts can only be paid out of earnings or income. For achieving this purpose the debt retirement sinking funds are created. The mental attitude of all creditors—whether of companies or of individuals—is the same. If the debtor is in a position to pay, they would rather not like to be paid, but if they are suspicious about the ability of the debtor to pay, they desire to be paid regularly and promptly. Thus ability to pay is the rock foundation of creditworthiness. A well administered sinking fund reserve creates confidence and not only the market for the outstanding securities of the company is well sustained but also subsequent issues whether for refunding or for financing expansion programme are well received by the investors. Thus a well-concerned and properly executed reserve policy is supplementary and complementary to the main financial policy of the business aimed at earning profits while keeping the capital investment intact.

Certain important types of reserves may be discussed here briefly. Depreciation reserve may be taken up first. At the outset it may be mentioned that there is a clear distinction between maintenance and depreciation. Maintenance is an operating expense and is deducted from gross income. If ever it is shown as a reserve, it is merely an unpaid liability, it may have to be met in cash shortly. Depreciation may also be called an expense which is usually deferred for quite a long time and cash is required only when the depreciated asset is to be renewed or replaced. Depreciation is said to be aimed at meeting three purposes, viz., (1) the asset replacement, (2) capital valuation, and (3) cost allocation and income determination.

The adoption of the reproduction or replacement cost basis has to encounter numerous difficulties and objections. First of all an old asset is seldom replaced with one that is identical in design or cost as advancement in technology nearly always makes it possible to replace old equipment and machinery with better type of things which cost more. Secondly, the replacement cost has to be forecast at the beginning of the period during which the depreciation has to be charged, while this cost will not be known exactly till the end of this period. The changes in the replacement cost reflected in the prices of new equipment and machinery during the period may affect the depreciation charges and the net income. Thirdly in a big concern the assets are of a heterogeneous type like heavy machines, building, electric generators, etc., and no uniform method can be made applicable to the appraisal of their replacement costs. Most of them

have only a going concern value and not an open market value The general price level can be taken as an indicator of changes in the replacement costs But the general price level is influenced very considerably by consumer prices and it will be wrong to confuse the producer goods prices with the consumer prices There is yet another objection to the adoption of replacement cost as the bases of charging the depreciation Depreciation charges *form part of the operating expenses and effect the production costs If the costs of goods are raised to meet higher replacements in future the sales* may decline unless the business enjoys a monopolistic position It will also be wrong to charge more from the present-day consumers to provide additional capital required to meet the needs of the future consumers It may be argued, perhaps correctly, that replacement costs represent the problemes of future financing rather than of present accounting It may, however, be mentioned here that the discussion of replacement costs has moved from the realm of pure theory to the field of present-day practical problems Since the end of the second war *the replacement costs have been rising continuously for such a long period of time, as they, perhaps, never did before High taxation, combined with paucity of savings, has made the position of the supply of fresh capital for replacement of productive* assets very critical

Recognition was given to this need of replacement of depreciated assets for which the provision of depreciation fund has become inadequate on account of the ever rising prices of capital goods and as early as 1945 the British Government gave some alleviation of the burden of business taxation by allowing firms to write off 20 per cent *of cost of new plant or machinery in the first year of its life, in addition to normal depreciation for the year It came to be known as the 'initial allowance*

For two or three years after the war the urgency of the question of maintaining the business capital intact was marked by the large liquid reserves which had been built up by many concerns on account of the difficulty of getting capital replacements except for those purposes which were essential to the war effort But by the end of the year 1948, major part of these war-time reserves had been used up and it was becoming clear that current earnings were generally inadequate to meet the current costs of replacement and maintenance as well as to pay even a modest dividend As the leaders of business began *to make increasingly urgent representations for a further concession, the government increased the special depreciation allowance on new plant and equipment in the first year of its life from 20 per cent to 40 per cent in addition to normal depreciation The Government of* India recognized this problem in 1954 and at the present time (1967) the special depreciation allowance is being permitted to certain priority industries at 35 per cent and to other industries at 20 per cent in the first year of the life of new assets in addition to normal depreciation under the name of 'development rebate' with the restriction that the amount thus reserved would not be available for purposes of dividend at least for the next eight years

The second purpose of depreciation with regard to its usefulness in valuation of the business enterprise may be discussed briefly. The occasion for the valuation of a business concern may arise at the time of amalgamation of a number of business units, the issue of new securities and rate determination in the case of the public utility concern. On such occasions it has to be determined whether the present worth of the assets is correctly represented by their book values. If the depreciation has been charged at higher or lower rates than was necessary or justified, some additions or deductions may have to be made to or from the book values of the assets to arrive at their current value or present worth.

In this way the depreciation policy is connected with the valuation of business assets. But unfortunately the manner in which depreciation should be applied on such occasions is not free from controversy as the question of value comes first and application of the rate of depreciation afterwards. Which of the three important methods of valuation (historical cost, replacement cost and capitalized earnings) has to be adopted? The capital goods are usually valued in terms of their earning power while the current assets may be valued in terms of the immediate market price. The difficulties to be encountered in connection with the replacement cost basis have already been mentioned. The historical cost has the advantage of being definite as it is a matter of record and does not require any forecasting of future earnings, costs, or general price level.

If the assets acquired at lower than the present cost are valued upwards, higher depreciation charges would give lower net income and consequently lower income taxes. The charging of depreciation on the basis of a higher replacement cost would also give the same results. Appreciation in asset values comes on account of external factors like an upward change in the price level and not on account of any internal change in the use of assets and as such these changes in asset values should not be mixed up with the depreciation policy of the business. For example, if the earnings of a company are doubled during a post war period of high prices it cannot wipe out depreciation by appreciating the value of its assets hundred per cent. Depreciation should also not be ignored on the ground that an improvement has taken place in intangible values like goodwill. The real appreciation in the values of certain assets like growing timber properties should also not be used to offset the depreciation in some other assets. Perhaps it has been correctly said that the hiding of the historical cost of some assets under the future values of other assets is a disservice to all interests.

Lastly with regard to the relationship of depreciation to income determination and to the unit costs it may be said that depreciation is to be treated as an operating expense and, therefore, has to be charged against operating income; it has also to be taken into account in fixing the unit costs. But it has to be remembered that the deduction of depreciation from income and the allocation of depreciation to unit costs are two distinct and separate financial processes and are

not to be mixed up The depreciation for a particular period may be allocated to the unit costs either on the basis of the quantity produced or on the basis of time during which particular assets were actually in use in the process of manufacture But the units of production should not be made the basis of calculating the depreciation The purpose of income determination is served if the investment in assets is recorded in the books at original costs and the depreciation is related to this cost This will also show correctly the actual value of capital and its relation to the income The difference between maintenance and depreciation has already been explained but the maintenance and depreciation policies are closely related to each other If maintenance is liberal and the assets are kept in good and efficient working condition they are likely to last longer and depreciation can be spread over a longer number of accounting periods and the rate can be lowered In certain cases maintenance takes the place of both and depreciation is not required to be charged separately The railway track is maintained properly and the rails are replaced piece by piece as they wear out There is no problem of renewing the entire tract at any one time and thus no depreciation is required Maintenance and phased renewal takes the place of depreciation Some companies link their maintenance and depreciation policies to the amount of their earnings and profits When earnings and profits are good maintenance is stepped up and higher amount is taken to depreciation reserves In lean years economy is made in maintenance and depreciation charges are also reduced Theoretically this policy is unsound

Besides gradual depreciation obsolescence of plant, machinery, equipment, etc , also presents a problem of a somewhat different type, which has to be taken care of by the management The difference between depreciation and obsolescence may be noted at the outset The causes responsible for the wearing out of the machinery in the process of its use in future are likely to be very similar to those of the past and hence the depreciation policy is based on past experience but the possibility of a machine becoming out of date on account of some invention is an event of the unknown future and the past experience cannot be helpful in anticipating obsolescence Thus depreciation is related to the known past and obsolescence to unknown future Depreciation occurs inside the factory as the machines wear out but obsolescence emerges out of the economic environment as the technological changes lead to the development of new and better types of machines and processes making the existing machinery out of date Thus we can say that depreciation represents a physical change, and can be estimated and provided for but obsolescence is non-physical and economic and can only be met as and when it comes Obsolescence is brought about not only by inventions and technological changes but also by changes in style and fashions, which render the products of efficient and well equipped concerns almost unmarketable Similar problems of obsolescence are presented when certain industries are called upon to meet the exigencies of the declaration of a war or of the return

to peacetime conditions Sometimes these circumstances emerging out of the economic environment compel the business units either to modernize or to close down The firms which have conserved a part of their past earnings in the form of general reserves may be able to finance modernization out of their own funds, others may have to resort to fresh financing by issuing new securities Thus obsolescence can be treated in two ways In those industries where some estimate of obsolescence is possible, periodical deductions from earnings should be made and transferred to a general reserve Correctly speaking, this income is being conserved and not being reserved In other cases where estimates are likely to be nothing better than mere guesses the only course open to the companies is to take recourse to new financing.

In certain industries like timbering, oil refining and mining, the principal assets or properties like standing timber, oil and mineral reserves are of an exhausting nature When the timber has been cut, the oil has been pumped out or the mineral has been extracted the site or area of operations has to be shifted to some other suitable locality or region It almost amounts to restarting the business The fact of the exhaustion of properties is called depletion It can be clearly differentiated from depreciation Depreciation *is charged to offset the wearing out of a machine which can be re-*placed by a new machine purchased from the market or the makers when the old one is no longer useful But it is not easy to acquire oil bearing areas or new mineral deposits Deserted mining towns and abandoned oilfields bear testimony to the fact that depletion is a reality The acquiring of new properties entails a good deal of effort and expenditure in taking out a new licence, prospecting, and arranging a lease Further effort and expenditure is required for developing the new properties into useful and income yielding properties

In the case of properties or assets depletion, unless adequate funds are accumulated by deductions from gross income in the form of depletion reserves, the dividends in part, will amount to repayment of original capital contribution by the shareholders Thus it is necessary for the companies operating in the field of extractive industries to provide for depletion reserves from their gross earnings *and to reinvest them in the acquisition of new properties unless* they propose to go out of business after the exhaustion of their existing properties All the oil and mineral working companies, which have been in existence for a considerably long period of time have been accumulating depletion reserves and have been reinvesting them in acquiring new rights leases, etc , in the neighbouring or even distant regions and have been shifting the scene of their operations from exhausted properties to new sites in areas or regions acquired by the use of funds accumulated through the provision of depletion reserves The depletion reserve may reasonably be built up on the basis of original investment in properties

(b) Surplus and Dividend

Surplus results from a flow of value into the corporate estate from outside Earnings are from outside the corporation sells its products to customers outside and more value is received in return Owners increase their investment in the corporation when they buy the stocks or shares at a premium The additional value in the form of premium comes from without Similarly when the values of land or other assets go up the value originates outside the corporation from the economic environment According to the sources from which the surplus results it may be classified into (a) earned surplus and (b) capital surplus Surplus which is obtained from the circuit flow of the working capital and originates in the operating income of the corporation is called *earned surplus* Interest earned on investments, rental incomes and unappropriated profits also form part of earned surplus From the point of view of sound financial principles dividends should be paid only out of this type of surplus

Capital surplus may be either paid-in surplus or it may be valuation surplus Paid-in surplus results when shares or stocks are subscribed at a premium Stated capital no-par stock is set up by a corporation at less than the total sum paid by the subscribers, or surplus accounts of several consolidating corporations are added up Valuation surplus results when the assets are revalued upwards or some of the liabilities are scaled down This type of surplus from the point of view of theory may not be distributed in dividends The earned surplus is usually appropriated for creation of various types of reserves, which have already been discussed and for payment of dividends The remaining unappropriated earned surplus may be designated as undivided profit or free surplus

Surplus thus represents the value that remains in the business after all the expenses and taxes have been paid or provided for, all the contractual obligations to the creditors have been met, and the necessary reserves for the seen and unseen future needs have been created This surplus is available for being distributed to the shareholders in the form of dividends But as the personal liability of the shareholders is limited to the amount subscribed by them towards the share capital of the corporation certain legal restrictions on dividends have been imposed in different countries to protect creditors and also preference shareholders against the excessive depletion of the surplus

Such restrictions usually provide that (1) no dividends may be paid if the corporation is unable to pay its debt obligations as they mature (2) no dividends may be paid unless after the payment the value of assets exceeds the total of share capital and liabilities, (3) no dividends may be paid except out of the balance of earned surplus The essence of these restrictions is that the existence of surplus is an essential pre-condition for the payment of dividends It implies that the contribution of the shareholders towards share capital must not be returned to them in the form of dividends In simple words it

amounts to saying that dividends cannot be paid out of capital Sometimes restrictions are also placed on payment of cash dividends out of surplus resulting from an unrealized appreciation of assets The necessity of making proper allowance for depreciation is also being increasingly recognized

The provisions of the Indian Company Law in this regard may be stated here briefly Dividends cannot be paid out of capital but interest can be paid out of capital under certain specified circumstances In the ordinary course a company cannot pay interest out of its capital on shares issued by it But Section 208 specifies the conditions under which any payment of interest may be made out of capital of a company The permissible cases are where by the Articles of a company or by a special resolution shares are issued for the purpose of raising money to defray the expenses of the construction of any works or building or the provision of any plant which cannot be made profitable for a length of time and the company pays interest on so much of the share capital as is paid up and charges the sum so paid to the cost of construction Every such payment will also require the previous sanction of the Central Government who may at the expense of the company cause an enquiry to be made on the circumstances of the case and permit the payment for such period only as may be determined and in no case beyond the end of the half year following the actual completion of the plant The interest must in no case exceed 4 per cent per annum or any other rate which the Central Government may permit The payment of the interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid

With regard to the payment of dividends out of profit the Indian Company Law provides that (i) a company cannot declare or pay dividend for any financial year except out of the profits of the company for that year arrived at after providing for depreciation in accordance with Section 205, (ii) or out of profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with these provisions and remaining undistributed profits, or out of both or out of moneys provided by the Central Government or a State Government for the payment of dividend in pursuance of a guarantee given by that Government provided that—

(a) if the company has not provided for depreciation for any financial year or years which falls or fall after the commencement of the Companies (Amendment) Act, 1960, it shall, before declaring or paying dividend for any financial year provide for such depreciation out of the profits of that financial year or out of the profits of any other previous financial year or years ,

(b) if the company has incurred any loss in any previous financial year or years which falls or fall after the commencement of the Companies (Amendment) Act, 1960, then the amount of loss or an amount which is equal to the amount provided for depreciation for that year or those years whichever is less be set off against the

profits of the company for the year for which dividend is proposed to be declared or paid or against the profits of the company for any previous financial year or years, arrived at in both cases after providing for depreciation in accordance with the provisions of Section 205 (a) or against both ,

(c) the Central Government may, if it thinks necessary to do so in the public interest, allow any company to declare or pay dividend for any financial year out of the profits of the company for that year or any previous financial year or years without providing depreciation

Provided further that it shall not be necessary for a company to provide for depreciation as aforesaid Where dividend for any financial year is declared or paid out of the profits of any previous financial year or years which falls or fall before the commencement of the Companies (Amendment) Act, 1960 [Section 205 (1)]

(ii) For the purpose of ascertaining profit, depreciation shall be provided either

(a) *to the extent specified in Section 350 (i e , the amount of the normal depreciation allowable under the Indian Income Tax Act for the financial year for which the net profits for taxation purposes are to be computed but will not include any arrears of depreciation or any special, initial or other depreciation or any development rebate)* , or

(b) in respect of each item of depreciable asset for such an amount as is arrived at by dividing 95 per cent of the original cost thereof to the company by the specified period in respect of each asset , or

(c) on any other basis approved by the *Central Government* which has the effect of writing off by way of *depreciation 95 per cent* of the original cost to the company of *each depreciable asset on the* expiry of the specified period , or

(d) as regards any other depreciable asset for which no rate of depreciation has been laid down by the Indian Income Tax Act or the rules made thereunder, on such basis as may be approved by the Central Government by any general order published in the official Gazette or by any special order in any particular case

When the depreciable asset under Clause (b) and (c) is discarded and sold it must be accounted for according to Section 350 in the financial year of its sale (Section 205)

To state briefly, the law makes the provision of at least a certain minimum amount of depreciation compulsory before the declaration of the payment of dividends can be made

Besides the provisions of law with regard to the surplus available for the distribution of dividends there are a number of important financial and economic factors also which have to be taken into consideration before taking a decision with regard to the payment of dividends

In the absence of earned surplus the payment of dividends out of capital surplus should be avoided even if there are no legal restrictions on payment of dividends out of such capital surplus In the U S A the corporations also sometimes possess capital surplus which is really paid in surplus In reality this surplus should be considered a part of capital stock or share capital and as such original investment or contribution The creditors may expect the original investment not to be impaired by the distribution of dividends There can of course be no objection to the payment of dividends which include besides profits a portion of original investment, in the case of mining or real estate companies provided the shareholders are informed that the dividend is a liquidating rather than an earned dividend

The obligations of the corporation or company towards institutional creditors or debenture or bondholders may also impose certain restrictions upon the management with regard to the distribution of the available surplus in dividends. There may be provision in the indenture that the surplus which existed at the time of its creation may not be used for distribution of dividends beyond a certain modest limit and thus the dividends may be paid only out of the surplus earned after the creation of the debt Such restrictions freeze the surplus existing at the time when the debt was incurred, for the duration of the debt as an additional investment by the shareholders Provisions of the loan contract may also require a certain level of liquidity or the ratio of the working capital existing at the time of contract to be maintained Such covenants with the creditors should be respected by the management Even from the point of view of new shareholders who purchase the shares at a premium and thus pay a price for a portion of the accumulated surplus it is desirable that the dividends should be paid out of the current earned surplus only because the payment of substantial cash dividends out of the accumulated surplus would amount to the repayment of a part of their principal as taxable income

Merely the existence of profits or surplus is not enough to justify the declaration and payment of a cash dividend. For this purpose a very thorough examination of the working capital and cash in the bank is very essential. Profit or surplus is an accounting phenomenon. The profit realized on sales may exist in the form of receivables or it may have gone into inventories or even into fixed assets and may not be available as liquid fund in the bank for the payment of dividends Even when cash is available it may be required for meeting certain long term obligations in the near future or the cash resources may be required for the expansion in the form of retained earnings Cash dividend may be paid only after taking into consideration the various immediate needs for cash and working capital

The need for the retention of earnings has also to be taken into consideration before the declaration and payment of cash dividends In the case of new companies some difficulty is usually

experienced in selling new securities on favourable terms and retained earnings have been the main source of financing growth in the industrial and manufacturing sectors The good effect of retained earnings is reflected in the rising prices of the equity shares and improved credit standing For a new company it may be, therefore, desirable to retain a part of their earnings for expansion rather than pay high dividends

The differences in the rates of personal and corporate taxation also affect the policy of dividend distribution The companies which are controlled by a group of persons whose personal incomes are subject to high rates of personal taxation usually prefer the retention of earnings and growth in share values over the distribution of cash dividends, as appreciation in the values of shares creates no personal income tax liability

Most of the factors discussed earlier play an important role in the determination of a good dividend policy but the maintenance of an attractive dividend rate over a period of time covering various phases of a business cycle is of special significance as it enhances the reputation of the corporation as a financially sound and strong organization and leads to the maintenance of share values and creditworthiness A record of uninterrupted dividends is a very valuable achievement, which the corporations must strive to attain The regularity of dividends generally depends upon the relative stability of earnings through the ups and downs of the business cycle and the availability of ample cash for distribution Comparatively the earnings of the companies engaged in the production or merchandizing of low priced necessities of everyday life like food, tobacco, soap, etc , and of the public utility companies (gas, electricity, telephone, etc), are more stable and they can easily strive to maintain regular dividends In the case of a large variety of industrial companies the earnings are subject to considerable fluctuations and they generally follow a policy of letting the quantum of dividends fluctuate with the variations in the curve of their earnings But even these companies can strive successfully to minimize the fluctuations in the rate of their dividends by limiting disbursements from the surplus in good years of prosperity and by displaying a certain measure of generosity in lean years of depression or adversity In the United State of America a number of major corporations having a large number of shares like the American Telephone and Telegraph Company, the General Motors Corporation, the General Electric Company, etc , have constantly strived to maintain regular dividends over a periods of decades *The case of American Telephone and Telegraph Company can be cited as an unique example of maintaining a record of regular dividends over a long period of time by following a very judicious policy of using their surplus to the best advantage The company began to pay a dividend of $7 per share in 1922 and maintained this record even during the deep depression of 1930's, even when the earnings fell below that figure* During the period of 20 years between 1930 and 1949, the total amount of dividends actually exceeded the consolidated amount of earnings by a small

margin. In nine years out of the twenty the dividend was greater than earnings. In 1959 there was a share split of three for one and the rate of dividend on new shares was raised from $3 per share to $3.50 per share. In 1961 this rate was again increased to $3.60 per share. Thus there is an unbroken brilliant record of regular dividends almost over a period of half a century. The company is a public utility concern and as such its earnings are comparatively stable. But the notable point in the case of this company is the most judicious use of the surplus—it has been conserved during the periods of prosperity and has been used to the best advantage during the periods of adversity.

The factors affecting the determination of the dividend policy of a company have been discussed briefly. Now we have to take up the question of the declaration of the dividend. The profits are the property of the company and not of the individual shareholders and the payment or withholding of the dividends is a matter of business policy over which the directors have complete jurisdiction. So long as the directors act in good faith and no fraud is involved the shareholders cannot force the directors to pay any part of the profits as dividend. The courts will not interfere in the matter of the declaration of the dividend unless they are satisfied that in declaring the dividend the directors were actuated by some motive other than the best interests of the shareholders.[1]

In India the articles of the most of the companies empower the Board of Directors to allocate the profit to different reserves when annual accounts are prepared and also to determine the rate of dividend and recommend it to the general meeting of the shareholders for formal declaration. The decision of the Board on the rate of dividend is final. The shareholders in the general meeting cannot compel the Board to declare dividends. Nor can the members compel the Board to increase the rate of dividend. They can, however, reduce the rate of dividend recommended by the Board.

The articles may also empower the directors to declare interim dividends, i.e., dividends in between the periods of two ordinary general meetings of the shareholders, as appear justified to them by the profits of the company. Dividends may be paid out of estimated profit, although not actually realized, unless articles provide that they should only be paid out of realized profits. Realized profits must be taken in the ordinary commercial sense (profits tangible for the purpose of division). Directors who treat estimated profits as realized and pay dividend out of capital on the chance that sufficient profits

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1 The Ford Motor Company of the United States of America earned good profits in the year 1916 but its Board of Directors decided to limit the dividends to the current rate and use the surplus funds to expand production to provide more employment. Minority shareholders brought a suit for more liberal dividends. The court upheld their plea and ordered a higher dividend on the ground that the duty of the directors was to administer the company for the benefit of the shareholders rather than for humanitarian purposes. This is a solitary example of interference by the court.

might be made, will, however, be jointly and severally liable, as upon breach of trust

The declaration of the dividends *on preference shares also is at the discretion of the directors Their decision in this matter is, however, very much influenced by the necessity of maintaining the credit of the company and the consideration of the possible shift in voting power which the non-payment of a certain number of pre ference dividends is likely to bring about* [1]

The corporate dividend policy is an integral part of the corporate financial policy The Board of Directors should have full freedom to adopt a suitable dividend policy The investors in equity or risk capital expect a higher return on their investment than is generally available on other forms of investment which are considered to be safe Secondly when there is no guarantee of a minimum logically there should be no statutory limitations on the maximum that a company can afford to pay in dividends in good years Higher dividends in good years are necessary to revive the spirit of optimism in the investors which suffers a setback during bad years when there are no dividends or they are paid at a low rate There are one or two instances of Government interference in the divi dend policies followed by the companies in India In 1955-57 the Indian Iron and Steel Company was prevented by the Government from paying a dividend which was warranted by the size of its profits and was asked to pay a lower rate of dividend This action of the Government affected adversely the capital market at Calcutta on account of the eminent position occupied by the securities of this company on the Calcutta Stock Exchange Earlier also the Government had passed the Public Companies (Limitation of Dividends) Act, which was fortunately allowed to lapse in less than two years time in March 1950 Under the Finance Act of 1965, income tax at $12\frac{1}{2}\%$, was levied on the amount representing the face value of any bonus shares issued to the shareholders during the previous year except when such shares were issued wholly out of the share premium account of the company This was a restrictive provision limiting the distribution of profits in the form of bonus shares and was deleted in the Finance Act of 1966 But a new restrictive provision was included in this Act of 1966 The Act provided that in the case of a company in which the public are substantially interested income tax at $7\frac{1}{2}\%$ shall be levied on the amount of dividends declared on its equity shares in excess of 10% of its paid up equity share capital as at

[1] According to the Indian Company Law (sec 87), a preference shareholder is entitled to vote on every resolution before the company at any meeting, if at any time the dividend is in arrear in the case of cumulative preference shares, *for an aggregate period of not less than two years (which need not be cumula tive) or in the case of non cumulative preference shares,* either for a period of two consecutive years immediately preceding or for an aggregate period of not less than three years comprised in the preceding six years For this purpose the dividend shall be deemed to be due in respect of any period whether declared *or not, on the last day specified for the payment of such dividend in the articles* or other instruments executed by the company in that behalf

the beginning of the previous years This provision discourages the cash dividends beyond 10 per cent

Types of dividends Dividends are usually distributed in cash but they *can also be distributed in other forms* of assets like investments or inventories or in the form of liabilities like scrip or bonds or in the form of stocks or shares An optional form of dividend is also possible in which the company can give an option to the *shareholders to receive their dividend either in cash or in stock*

Property or asset dividends Cash dividend is a form of asset dividend but sometimes profit is available for the distribution of dividends but cash position of the company is not very comfortable *although there are some other assets which the company does not* want to retain These assets may consist of outside investments or the shares of the subsidiary concerns In place of cash these investments or shares may be distributed as dividends In the United *States of America some distillery companies have been known to* distribute dividends in the form of liquor Such dividends are the examples of *inventory* dividends

Liability dividends These dividends are paid in the form of *short term notes with or without interest If a company* has earned profits and is in a position to distribute dividends but is temporarily short of cash, in such a case the company may give promissory notes (60 or 90 days) in place of cash to its shareholders as dividend This form of dividend is known as *scrip dividend* In rare instances dividends are paid in bonds or long term notes These dividends are called *bond dividends* and the shareholders who receive *these bonds or notes become the creditors of the company and are* entitled to receive interest

Stock dividend In the United States of America stock dividends rank next after the cash dividends in frequency and amount. Large stock dividends usually *have two objectives to serve* The first objective may be to capitalize the surplus to finance the growth of the enterprise The second objective may be to make the prosperity of the company appear modest in the eyes of the public and thus escape the criticism of making excessive profits The stock dividends are not treated as taxable income as the cash dividends are treated and even if a shareholder sells the stock given to him as dividend he has to pay *income tax only on the part of the* price of the stock sold by him which represents a capital gain. Thus there is a tax advantage to the shareholders if the dividend is given in *the form of stocks* The stock dividend leaves the *position* of the equity of the stockholders unchanged, because the net worth remains unchanged It is simply divided in a large number of shares After the distribution of stock dividend the prices of shares will decline and the rate of dividend per share will also be reduced. Small stock dividends are used only as a substitute for cash and their main purpose is to give the stockholders some tangible evidence of retained earnings

In the case of optional dividend the shareholder has the choice

of taking cash or stock He has to communicate his choice to the company within a prescribed time limit after receiving the notice of dividend Small shareholders may usually prefer to receive cash on account of the trouble of selling the stock unless the price of stock is somewhat higher than the cash offered as dividend

In India the process of capitalizing the surplus is called the issue of bonus shares In the United States of America the distribution of stock dividends is a common feature of dividend distribution but in the case of India the issue of bonus shares is not so much a part of the policy of distribution of dividends as it is a part of the programme of procuring more capital with the only difference that in place of asking the shareholders to pay in cash the price of shares allotted to them from a 'right issue' the price of bonus shares is paid on their behalf by the company out of its retained earnings The bonus shares are given to the shareholders in proportion to the shares already held by them On account of the tight conditions prevailing in the capital market in India and a comparative paucity of fresh investible funds available in the country the procedure of issuing bonus shares for augmenting the capital resources for growth on a permanent basis, has been used quite frequently during the period of five year plans

The process is subject to certain limitations from the point of the general industrial economy of the country, the profit earning prospects of the company itself and the individual shareholders, and as such has to be used with caution From the point of view of the industrial economy of the country, the surplus funds are not allowed to flow to those sectors of the economy where they may be needed the most as the use of these funds is restricted to particular companies only The capital market is also deprived of the secondary funds which might have flowed to many diverse fields From the point of view of the company issuing the bonus shares the most important consideration should be the possibility of increased future earning to maintain the rate of dividend on its enlarged capital base From the point of view of the shareholders the process of issuing of bonus shares deprives them of their liberty of the choice of investing these incomes from dividends in any field of economic activity or of using it for the satisfaction of their personal wants Before using bonus shares the directors should consider all these limitations carefully

(c) Management of Earnings in India

Historical Review—The entire modern industrial system of the world is only two centuries old , the modern industrial system of India is hundred years old The modern industries were started in India after 1850 by two sets of people—the Europeans and the Indians The Europeans started new industries like jute or sugar in eastern and southern India They had at their back sufficient experience of industrial management and industrial finance which they had acquired in their own countries But the Indian entrepreneurs like the Parsis or the Gujaratis who started mainly cotton mills in

western India had no previous experience of industrial management or of industrial finance. There were no modern financial institutions also. Perhaps most of the concerns (mainly cotton mills) were started in western India with inadequate capital resources from the very beginning and substantial amounts were borrowed on high rates. In the beginning the profits were not good and whenever good profits were earned there was an anxiety to pay as high dividends as they could to create an impression of prosperity in order to attract more funds and to keep the lines of credit open. The importance of adequate depreciation and other reserves and of a stable dividend policy was not perhaps properly realized or understood. This state of affairs continued from 1850 to the end of the boom in near about 1922. This period was followed by a period of intense foreign competition and the world depression (1929-33) and the Indian industrialists could not get any breathing time to think over their past mistakes committed during the days of prosperity enjoyed by the industries during the period of the first World War (1914-18) and the post-war boom (1918-22).

As the profits earned during the period of prosperity were literally squandered in paying high dividends without providing for even the minimum requirements of depreciation allowed by the income tax authorities and almost without any retained earnings for expansion or any other reserves for obsolescence or for dividend equalization. Naturally when the profits began to decline after the post-war boom (1918-22) the Indian industries found themselves in great difficulties and could do nothing to prevent a rapid decline in the rates of dividends. The policy followed by the managements of the textile industry with regard to the management of earnings and the results of that policy are illustrated in the following table:

***Financial Position of Bombay Mills*[1]**

(Figures in crores of Rupees)

Year	*Amount of depreciation written off*	*Net Profit*	*Dividend*	*Percentage of dividend to paid-up capital*
1917	·85	3·02	1·69	22·2
1918	·87	2·28	1·91	23·7
1919	1·44	6·15	3·77	40·1
1920	1·63	10·10	5·98	35·2
1921	1·81	8·46	5·34	30·0
1922	1·38	3·81	2·94	16·4
1923	·75	·33	·93	4·9
1924	·42	2·42	·60	3·1
1925	·31	2·87	·43	2·2

[1] The Report of the Tariff Board on Textile Enquiry (1926-27).

It is quite evident the huge profits earned during the war-time and the post-war boom were recklessly used by the management in paying very high dividends without making any provision for augmenting the divisible profits during the lean years It was pointed out in the Legislative Assembly on September 24, 1924, that the cotton mill companies of Bombay, during the eight years ending with 1922 paid out an overage dividend of 53 per cent on an average capital of 12½ crores of rupees, or a total of more than 50 crores of rupees

The comments of the Bengal Provincial Banking Enquiry Committee[1] on the distribution of large dividends are quite significant The committee observes "We have, however, been unable to understand why no serious attempts are made for building substantial reserves, when such high dividends as 50 to 150 per cent are paid If the dividends be limited to say, 15 per cent, for a few years, and the cost of the profits carried to the reserves, most of the tea gardens will be able to accumulate a sufficient reserve fund for meeting their annual recurring expenses from this fund Borrowing then would be unnecessary, and interest on loans saved The result will be larger dividends in future"

In distributing high cash dividends the Indian industrialists did not give enough thought to the availability of liquid cash resources to meet their normal working capital requirements, but, on the other hand, continued to complain about the unhelpful attitude of the commercial banks of the country in their reluctance to make liberal advances which showed lower profits

On the one hand the managements were distributing so high dividends but on the other they were very negligent or unmindful about the necessity of providing for adequate depreciation and some other types of important provisions like the obsolescence and dividend equalization reserves In the case of cotton textile industry the income tax department allowed for depreciation (1) 2½ per cent on block cost of buildings, (2) 5 per cent on block cost of spinning and weaving machinery, and (3) 7½ per cent on block cost of bleaching and dying machinery and electrical equipment But rarely the cotton mill companies followed these rates in practice The cotton mills in Bombay set aside for depreciation only 3 per cent of the original cost of land, building and machinery during the years 1917-25, which was perhaps the best period in the history of the Indian cotton mill industry[2] According to the rate of 2½ per cent on buildings and a flat rate of 5 per cent on the machinery they aught to have set aside for depreciation Rs 12 32 crores, but instead of this, they set aside only Rs 9 crores[3] In reality this amounted to the dissipation of

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[1] The Report of the Bengal Provincial Banking Enquiry Committee, Vol I p 121

[2] In 1915 to 1922 both years inclusive, they paid an average dividend of 53 per cent on an average capital of 12½ crores of rupees And they paid away in the eight years ending 1922 a sum of over 50 crores of rupees in dividends (Report of the Indian Tariff Board on Textile Industry 1927, Vol. III, p 468)

[3] *Report of the Indian Tariff Board on Textile Industry, 1927, Appendix VI.* (p 241) to Volume I

more than Rs 3 crores of capital resources in dividends during these years The depreciation charges for certain Ahmedabad cotton mills, for the years 1923, 1924 and 1925, at the rate of 4 per cent aught to have been more than Rs 120 lakhs But the actual provision made for depreciation amounted to only Rs 81 lakhs During the same *period* Rs 121 lakhs *were distributed as dividends by these mills*[1] This really meant that the distribution of dividends to the extent of Rs 40 lakhs was a payment out of capital and not out of profits which were inflated and overstated on account of inadequate provision of depreciation

In a number of other industries like paper the provision for depreciation was not adequate The Tariff Board on paper industries found that the usual practice was to charge as depreciation a certain amount of profits *determined in an arbitrary manner* without any definite relation to the value of the block A leading paper mill, the Titaghur Paper Mills Company, had only one reserve for all purposes, depreciation, obsolescence, contingency, or dividend equalization A certain amount from the profits as permitted by the dividend distribution policy of the year, was set aside as reserve and used for these purposes[2] In the opinion of the Tariff Board even a progressive industry like the Iron and Steel Industry was found wanting in the matter of providing adequate depreciation The Board in its report observed "The steel industry is still undergoing rapid changes in the process of manufacture A concern engaged in this industry, therefore, must always be ready to adopt the latest changes *Our steel industry does not seem to have* paid any *attention to* this feature Far from making any provision for obsolescence, our companies do not make sufficient allowance even for depreciation"[3]

After 1925, the Indian industries were *not doing* well and most of the well established industries had to be protected During the period of depression the Bombay cotton mill industry found itself in great difficulties and according to the observations of Indian Tariff Board (1935-36), the mills were not making sufficient profits to cover the depreciation allowances to which they were entitled and the large amounts required for interest on borrowed money The position of *the cotton textile industry of Bombay between 1926 and 1935* is illustrated in the following table

[1] Report of the Indian Tariff Board on the *Textile Industry, 1927, Vol II* p 524, Annexure to the Ahmedabad Millowners Association s Evidence
[2] *The Indian Tariff Board on Paper and Paper Pulp Industries, Evidence*, Vol I, p 127
[3] *Indian Tariff Board, Statutory Enquiry, 1926, Steel Industry Report*, Vol. IV

Financial Position of Bombay Mills[1]

(Lakhs of Rupees)

Year	*Net Profit*	*Dividend*	*Percentage of dividend to paid-up capital*
1926	192	42	2 2
1927	211	61	3 4
1928	255	28	1 7
1929	229	23	1 5
1930	137	19	1 4
1931	106	18	1 4
1932	161	18	1 4
1933	130	12	1 1
1934	69	21	1 9
1935	92	20	1 8

The declining trend of profits, dividends and the percentage of dividends to the paid-up capital is quite apparent Had the managements been a little more far-sighted in conserving the earnings of the companies during the period of prosperity, probably the impact of the adverse circumstances during the period of depression might have been somewhat mild and much less distressing

By the year 1935 and 1936 the process of recovery after the depression had set in and the beginning of the Second World War in 1939 brought the industries back to long period of profitable working By this time our industrialists had acquired enough experience of financial management of the companies and consequently the apportionment of earnings between depreciation and reserves on the one hand and the distribution of dividends on the other was more scientific Abnormal dividends like those of the first World War period were never distributed but an effort was made to make the dividends more regular and stable Depreciation was provided on a reasonable basis but high taxation set a limit to a liberal provision for depreciation and reserves Whenever the burden of taxation was reduced, normally there was a rise in the provision for depreciation The division of gross profits among the three heads—(1) provision for depreciation, (2) taxation, and (3) net profits in the form of percentages—is given in the table[2] on page 326

The percentage of provision for depreciation to gross profits showed an almost continuous decline up to 1943 in the case of cotton and paper industries and up to 1945 in the case of cement industry, whereas in jute and iron and steel the movement of this percentage was rather irregular In marked contrast to the movement of the percentage of depreciation the percentage of provision for taxation to gross profits rose almost continuously in cotton and jute industries up to 1944, in paper and iron and steel industries up to 1943 and in cement industry up to 1945 The rise in the percentage of taxation

[1] Adarkar, B P *The Indian Fiscal Policy* (1941), p 152, Table IV, Part I

Trends of Provision for Depreciation, Taxation and Net Profits as Percentages of Gross Profits, as per Main Table of each Industry

Years	Iron & Steel			Cement			Paper			Cotton			Jute		
	Depreciation	Taxation	Net Profit	Depreciation	Taxation	Net Profit	Depreciation	Taxation	Net Profit	Depreciation	Taxation	Net Profit	Depreciation	Taxation	Net Profit
1939	10 73	24 75	64 52	53 53	12 02	34 45	36 88	24 65	38 47	58 55	9 59	31 86	14 11	24 25	61 64
1940	21 54	32 72	45 74	50 72	8 35	40 93	28 82	37 96	33 22	46 10	7 12	46 78	14 91	32 65	52 44
1941	17 36	42 98	39 66	43 31	14 66	42 03	19 70	54 16	26 14	27 58	27 89	44 53	8 62	60 06	31 32
1942	21 13	42 44	36 43	29 79	23 91	46 30	12 76	65 64	21 60	14 52	55 73	29 75	9 50	60 15	30 35
1943	18 40	47 64	33 96	36 45	34 25	29 30	11 14	66 36	22 50	4 94	75 35	19 71	9 64	61 72	28 64
1944	18 16	46 26	35 58	25 99	37 86	36 15	12 48	65 55	21 97	5 49	75 88	18 63	6 11	70 98	22 91
1945	19 35	45 58	35 07	24 02	43 66	32 32	12 86	60 40	26 74	7 51	66 55	25 94	6 99	63 92	29 09
1946	26 24	38 19	35 57	26 21	35 88	37 91	16 22	44 21	39 57	11 06	47 98	40 96	9 06	46 98	43 96
1947	39 58	28 59	31 83	39 11	28 11	32 78	25 50	36 83	37 67	12 99	44 18	42 83	10 33	41 08	48 59
1948	36 44	28 91	34 65	25 60	49 04	25 36	20 50	38 07	41 43	8 49	45 15	46 36	11 33	39 04	49 63
1949	40 03	25 29	34 68	33 25	32 80	33 95	21 40	32 12	46 48	24 13	35 88	39 39	Loss	Loss	Loss

was usually higher than the fall in the percentage of depreciation which generally resulted in an almost continuous decline in the percentage of net profits to gross profits The cement industry paid comparatively less by way of excess profits tax and therefore the trends of percentages in this industry were slightly different The year 1944 is generally considered to be the peak year with regard to the incidence of taxation In this year the percentages of taxation reserves to gross profits were 37 86, 46 26, 65 55, 70 98, and 35 88 for cement iron and steel, paper, jute and cotton respectively

After 1944 the percentage of taxation reserves began to show declining tendencies and consequently the percentages of depreciation and net profits began to show an upward trend

With regard to the appropriation of net profits for the purpose of dividends and reserves between 1939 and 1949, usually a high percentage was paid in dividends reserves not neglected and a fair percentage of net profits was retained in the business This distribution of net profits is shown in the table on page 328 [1]

The table shows that the payments of dividends throughout the period were generally kept within the limits of the profits earned during the accounting period and the occasions for drawing upon past reserves in the case of cement, paper and jute industries were only few Roughly 60% of the profits after tax were distributed and 40% were retained in business

The payment of dividends in relation to capital has been moderate between 1939 and 1949 High dividends like those of the first World War period were not paid during the period of the second World War or the post-war period Dr H C Mehrotra has compiled a table giving average dividends per cent per annum from a series of articles written by Shri P C Jain of Allahabad University in *Capital* The table is being reproduced below[2]

Average Dividend per cent per annum

Paid in	Cotton	Jute	Paper	Engineering
1939	10 50	9 77	15 89	12 90
1940	10 88	18 92	13 75	12 96
1941	14 44	18 99	13 19	13 54
1942	27 03	15 07	16 56	15 00
1943	26 82	12 72	15 50	12 22
1944	17 88	13 09	13 09	15 87
1945	17 70	14 90	13 28	15 19
1946	18 14	19 96	14 37	16 66
1947	17 23	22 10	16 25	17 78
1948	13 12	15 02	11 25	15 87
1949	13 66	7 70	8 75	15 03

1 Mehrotra, H C *Company Earnings in India during the decade 1939-1949*, p 304 (unpublished thesis)
2 *Ibid*, p. 297

Trend of Dividends paid and contributions to the General Reserves as Percentages of Net Profits (Average)

Years	Iron & Steel Dividends	Iron & Steel Reserves	Cement Dividends	Cement Reserves	Paper Dividends	Paper Reserves	Cotton Dividends	Cotton Reserves	Jute Dividends	Jute Reserves
1939	68 33	20 60	116 67	4 65	76 47	19 33	92 10	12 29	58 18	5 15
1940	79 33	20 44	92 06	7 07	52 24	16 73	65 38	8 90	71 62	1 69
1941	75 60	24 40	97 57	11 17	66 16	24 62	41 63	16 71	73 45	10 79
1942	89 44	12 00	80 86	16 83	59 41	30 07	46 10	24 10	84 15	11 64
1943	83 05	18 18	123 48	15 65	57 53	33 25	31 96	27 56	53 86	8 05
1944	74 59	24 42	83 19	11 55	74 08	29 85	40 21	30 81	79 73	20 32
1945	76 72	20 84	84 41	17 35	63 79	30 04	40 31	33 47	69 66	24 64
1946	75 07	27 18	87 71	11 54	72 58	35 47	36 44	43 49	73 49	24 32
1947	91 74	2 24	107 04	—	100 20	28 92	31 14	48 86	68 91	27 83
1948	84 64	18 55	94 11	10 59	63 15	45 61	27 34	38 19	65 29	21 72
1949	83 12	21 39	73 19	29 53	53 86	52 59	73 35	54 61	Loss	Loss

It will be seen that the dividends have fluctuated between 10 and 20 per cent Occasionally they have risen to 26 or 27 per cent in cotton industry or fallen to 8 or 9 per cent in jute and paper

The management of earnings during the plan period has been very ably summarized by Dr H C Mehrotra and Sri S P Goyal of the Department of Commerce of the B R College Agra, in a paper entitled 'Corporate Dividend Policy in India', which was presented at the Commerce Conference in 1965

A table from the paper is being reproduced here (between pages 328 and 329)

The appropriation of profits after tax shows that roughly 65 per cent of such profits were distributed as dividends and nearly 35 per cent were retained as reserves In the case of iron and steel industry the profits distributed amounted to 40 or 50 per cent only and the remaining portion of profits was retained as reserves On the whole it can be said that since the beginning of the second World War the mana ements of companies in India have tried to observe a much better code of financial discipline than they had ever done before

The returns on risk capital during this period have not been satisfactory On paid-up capital they have roughly varied between 7 and 11 per cent and on capital employed between 4 and 6 per cent The returns in the case of textile industries have been still poorer If we take into consideration the rates of interest of 6 or 7 per cent being paid by the banks on fixed deposits then the rates of returns on risk capital employed in industry are really very poor, unsatisfactory and uninviting It is on account of these unsatisfactory returns that risk capital appears to be so scarce at the present time In case of a number of new issues it is said that large portions of underwritten issues remain unsold and the underwriters are obliged to take them up on their own account Heavy corporate taxation is one of the main causes of the present unhealthy state of the new capital issue market

Brief Comments on the Finances of Joint-Stock Companies in India

The Reserve Bank of India has published the financial statistics of non-government non-financial medium and large public limited companies, i e , companies with paid-up capital of more than Rs. 5 lakhs, from 1950-51 to 1962-63

The data have been published industrywise Hence, some important industries have been selected for a brief discussion here

Cotton Textile Industry

The average rate of net capital formation during the First Plan period was 1 7% per annum This increased to 9 2% per annum during the Second Plan period and more or less the same

rate continued during 1961-62 and 1962-63 For the growth of the industry internal and external sources of funds contributed 83% and 17% respectively during the First Plan period while during the Second Plan their shares were 43% and 57% The main causes of this reverse trend have been the heavy growth of the industry, the increase in taxation and dividend distribution The tax provision as percentage of profits before tax increased from 46% during the First Plan to 71% during the Second Plan and dividend distribution as per cent of profits before tax increased from 51% to 70%, hence the retained profits instead of increasing were reduced by 41% of profits before tax It is true that during the Second Plan period the industry distributed slightly higher dividends than during the First Plan but 5 1% dividend on net worth was not sufficient return to attract fresh capital This is clear from the fact that the major portion of external funds have been collected by issuing debentures and by borrowings instead of issuing new shares to obtain fresh capital

Sugar Industry

The average rate of net capital formation during First and Second Plan periods was 9 8% and 11 4% per annum respectively During 1962 63, the growth was −11% Internal and external sources of funds contributed 49% and 51% during the First Plan period while their share during the Second Plan period was 36% and 64% respectively The industry distributed higher dividends during the Second Plan period than during the First Plan period but without touching the retained profits This shows that during the Second Plan period the industry earned larger profits The taxes consumed more than their due, hence, the retained profits as percentage of profits before tax decreased from 24% during the First Plan period to 18% during the Second Plan period The industry distributed reasonable dividends to its shareholders and that too without touching its past profits

Iron and Steel Industry

The average rate of net capital formation during the First and Second Plan periods was 10 9% and 26 5% per annum respectively During the first two years of the Third Plan, the growth was in the reverse direction Internal and external sources of funds contributed 58% and 42% respectively during the First Plan period while these percentages during the Second Plan period were 38% and 62% Inspite of higher retained profits and less taxes during the Second Plan period the percentage contribution of internal sources was reduced from 58% to 38% The main cause of this reduction was the heavy investment in the industry which was not possible to undertake from internal sources During the Second Plan period the industry did not receive the return on the investment made during that period. hence, in spite of an increase in dividend as percentage of profits before that, the dividend as percentage of net-worth and paid up

capital declined from 6 1% to 4 8% and from 11 5% to 9 6% respectively The return on investment is revealed in the enhanced percentage of dividend during the Third Plan period with higher retentions

Engineering Industry

The average rate of net capital formation by this industry during the First and Second Plan periods was 11 5% and 15 8% per annum respectively The internal and external sources of funds contributed more or less the same percentage throughout the period under study The earnings of the industry have increased substantially during the Second Plan period as compared to the First Plan period By slight increase in dividend as percentage of profits before tax, the industry distributed more than double the dividend as percentage of net-worth and paid-up capital This happened on account of the net-worth remaining more or less the same with an increase in profits During the first two years of the Third Plan the industry distributed even higher dividends

Cement Industry

The average rate of net capital formation during the First and Second Plan periods was 8 6% and 12 2% per annum respectively The internal and external sources of funds contributed 86% and 14% respectively during the First Plan period while their share during the Second Plan period was 37% and 63% The main reason of this reverse trend was the decrease in earnings of the industry In spite of less taxes, less dividend as percentage of net-worth and paid-up capital, retained profits to a great extent

Paper Industry

The average rate of net capital formation during the First and Second Plan periods was 9 7% and 14 1% per annum respectively The internal and external sources of funds contributed 59% and 41% respectively during the First Plan period while their shares during the Second Plan period were 49% and 51% The main reason of this trend was the reduction in retained profits, on account of higher taxation and dividend distribution, and expansion of the industry The earning capacity of the industry remained constant The dividends, as percentage of net-worth, cannot be considered to be attractive for the risk capital

Conclusion

The overall profits of the industries under study can be judged by the rate of growth, retained profits and dividend distribution as percentage of net-worth In terms of net capital formation the iron and steel industry stood first and was followed by the engineering, paper, cement, sugar and cotton industries respectively In terms of retained profits, again the iron and steel industry stood first and was followed by engineering, sugar, paper, cement and cotton industries The sugar industry distributed the highest percentage of dividend as percentage of net-worth and was followed by cement, engineering, paper, cotton and iron and steel industries

Capital Formation (%), Sources of Funds (%), Profits, etc

Years	1951-52	52	53	54-	55	51-52 to 55-56	56	57	58	59	60	56-57 to 60-61	61-62	62-63
Cotton Textile														
Rate of Net Capital formation	9.7	4.5	2.3	0.8	0.6	1.7	23.1	12.5	0.8	0.3	12.8	9.2	8.7	11.9
Sources of Funds														
(a) Internal	69.2	75.3	37	73	140	83	41	7	43	81	60	43	82	22
(b) External	30.8	175.3	63	27	40	17	59	107	57	19	40	57	18	78
Tax as % of Profits before Tax	42.1	54.2	48.4	47.7	37.3	46	41.9	144.4	90.8	41.3	35.1	71	42.1	54.4
Div. as % of Profits before Tax	28.3	78.4	54.9	56.7	35.9	51	34.1	149.6	88.2	47.8	32.8	70	27.2	38.5
Retained Profits as % of Profits before Tax	29.6	-32.6	3.3	4.4	26.8	3	23.9	194	79	10.9	32.7	41	30.7	7.1
Div. as % of Net Worth	4.6	3.7	4.1	4.2	4.9	4.3	4.9	4	4.1	5.8	6.6	5.1	6.1	4.9
Div. as % of Paid-up Capital	8.7	6.8	7.5	7.5	9.3	8	9.9	7.5	7.4	10.5	12.9	9.6	12.4	10
Sugar														
Rate of Net Capital formation	27.4	2.9	22.3	21.1	29.3	9.8	18.6	6.2	4.5	7.6	32.6	11.4	13.3	11
Sources of Funds														
(a) Internal	37	55	47	25	30	49	40	68	252	43	15	36	28	35
(b) External	63	45	147	75	70	51	60	32	352	57	85	62	72	135
Tax as % of Profits before Tax	36	41.1	36.8	39	45.7	40	46.4	50.3	50.9	41.2	41.9	46	50.5	72.2
Div. as % of Profits before Tax	30.1	38.5	37.2	38.8	33.1	36	32.5	31.1	38.5	39.1	38.5	36	43.1	43.9
Retained Profits as % of Profits before Tax	33.9	20.4	25.9	22.2	21.2	24	21.1	18.6	10.6	19.8	19.6	18	6.4	16.1
Div. as % of Net Worth	5.5	5.4	6	6	6.3	5.8	6	5.9	6.6	7.9	7.6	6.8	6.4	5.5
Div. as % of Paid-up Capital	9.4	9.4	10.4	10.7	11.7	10.3	10.7	10.5	12	14.4	14.8	12.5	11.6	9.7

Iron and Steel Industry

Rate of Net Capital formation	6 7	10 5	9 3	12	16 1	10 9	44 8	72 7	23 4	4 6	0 3	26 5	-2 8	2 1
Sources of Funds														
(a) Internal	122	56	69	53	45	58	31	14	28	106	162	38	189	180
(b) External	-22	44	31	47	55	42	69	86	72	6	62	62	89	-80
Tax as % of Profits before Tax	39 3	39 5	40 6	37 3	36 3	39	42	23 5	3 2	4 3	12 8	17	25 9	22
Div as % of Profits before Tax	27	26 3	26 1	19 7	14 2	23	16	27 3	30 6	38 4	52 8	33	44 6	35 6
Retained Profits as % of Profits before Tax	33 7	34 2	33 3	43	49 5	38	42	49 2	66 2	57 3	34 3	50	29 5	42 3
Div as % of Net Worth	6 8	6 6	6 3	5 9	5 1	6 1	4	4	3 8	5 6	6 4	4 8	6 1	5 9
Div as % of Paid-up Capital	13	14 1	10 2	10 2	10 2	11 5	8 5	8 5	7 5	10 7	12 6	9 6	12 6	13

Engineering Industry

Rate of Net Capital formation	15 4	6 5	6 6	9	20 5	11 5	34 1	12	7	10 2	17 5	15 8	15 7	12 4
Sources of Funds														
(a) Internal	37	43	38	40	42	40	28	35	50	42	43	38	39	45
(b) External	63	57	62	60	58	60	72	65	50	58	57	62	61	55
Tax as % of Profits before Tax	49 2	50 9	48 8	47 6	41 2	48	51 1	47 5	48 2	44 5	42 4	47	47 1	58 3
Div as % of Profits before Tax	22 6	24 1	30 7	25	25 3	25	26 6	27 8	31 8	35 9	33 3	31	34 2	25 2
Retained Profits as % of Profits before Tax	28 2	25	20 5	27 3	33 5	27	22 4	24 6	19 9	19 6	24 3	22	18 7	16 5
Div as % of Net Worth	2 2	2 2	2 4	2 9	4 9	2 9	5 4	5 1	5 9	7 5	7 4	6 3	7 4	6 2
Div as % of Paid-up Capital	2 7	2 7	3	3 7	6 7	3 8	7 5	7 3	8 2	10 8	11 5	9	11 2	9 5

Year	1951-52	52-	53-	54-	55-	51-52 to 55-56	56-57	57-	58-	59	60	56-57 to 60-61	61-62	62-63
Cement Industry														
Rate of Net Capital formation	6.7	11.5	1.6	1.5	11.2	8.6	21.7	20.1	16.5	0.8	1.2	12.2	1.7	7
Sources of Funds														
(a) Internal	75	80	101	123	70	86	30	20*	39	61	78	37	65	71
(b) External	25	20	1	23	30	14	70	80	61	36	22	63	35	20
Tax as % of Profits before Tax	11.7	10.2	13.1	16.5	17.8	15	12	17	19.5	25.3	12.2	15	17.1	15.6
Div as % of Profits before Tax	31.2	35.5	37.7	31.9	30.1	34	36.8	57.1	50.1	63.8	63.6	51	55.1	37.3
Retained Profits as % of Profits before Tax	21.1	21.3	19	21.7	22.2	21	31.2	5.9	0.1	10.7	1.1	11	7.7	17.1
Div as % of Net Worth	7.1	7	6.6	6.5	6.1	6.7	5.7	6.7	5.3	7	7.5	6.1	6.9	6.5
Div as % of Paid up capital	8.7	9	8.9	8.9	9.1	9	8	9.2	7.3	9.6	10.3	8.9	9.8	9.1
Paper and Paper Products														
Rate of Net Capital formation	13	6.1	5.3	10.8	13.1	9.7	11.9	10.7	11.1	5	10.3	11.1	9.3	18.5
Sources of Funds														
(a) Internal	51	80	71	76	40	59	63	35	51	62	33	33	18	33
(b) External	16	20	29	21	60	41	37	65	49	38	57	51	52	67
Tax as % of Profits before Tax	11.8	17.9	11.1	18.5	17.2	18	55.6	18.9	15.2	10.6	10.1	15	24.1	16.9
Div as % of Profits before Tax	26.9	21	22.1	31	12.1	28	37.7	15.3	10.6	11.9	19.9	16	12.9	17.3
Retained Profits as % of Profits before Tax	18.3	18.1	11.2	27.5	10.5	31	6.7	15.9	21.2	28.5	21.7	19	19	15.8
Div as % of Net Worth	5.5	1.1	1	1.0	5.3	1.7	5.1	5.2	6	6.8	5.9	5.8	5.5	5
Div as % of Paid-up Capital	10.8	9.1	8.3	9	9.6	9.5	9.5	9.2	11.2	12.0	10.6	10.6	9.8	8.6

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Corporate Expansion and Amalgamation

Change is the law of life, it is inherent in the life of individuals as well as institutions None of the political, social, or economic *institutions of mankind stands still* In an age of large-scale enterprise, men have come to believe that to survive or to succeed, their business undertakings must expand and that they are doomed if *they contract Moreover, there is the universal desire of mankind* to grow, because growth in some form is essential to existence

The post-war years have been years of unprecedented business growth The pressures of deferred demand accumulated during the war plus a rapidly increasing population have created unusual market opportunities crying for satisfaction To these influences must be added new products based on new technology and new raw materials In addition, rising prices maintain a constant pressure in terms of both profit opportunity and financial need Under the circumstances it is not surprising that corporations expand operations both through the construction of additional capacity and by the acquisition of existing facilities by direct purchase or merger

Reasons of Expansion

The reasons of expansion are deep rooted and reflect an innate characteristic of progressive civilization Moreover, the internal urge of individual business leaders is stimulated by various forces of a psychological and an economic nature Among these, the following are noteworthy (1) Competition encourages growth and unless a corporation expands, it will frequently be surpassed by competing groups (2) The momentum developed by sound expansion is a source of validity and vigour (3) The possibility of greater profits is equally stimulating (4) Large-scale operations may permit economies and advantages not obtainable to the same degree on a smaller scale (5) Monopolistic ambitions may also be the cause of expansion

Kinds of Expansion

Usual methods of business expansion are two (1) internal and (2) external Large corporations and corporate groups come into being (1) by internal growth or through retained earnings, (2) by the sale of securities to the public or (3) by the acquisition of other business units by the use of such devices as the trust the holding company, the lease or outright fusion by consolidation and merger Expansion may be one of the following kinds

1. ***Expanding the market*** This may involve the establishment of wider facilities and expansion of the market which implies a corresponding increase in production

2 ***Increasing the number of products***

3 ***Making improvements*** Even though improvements may result in lower costs their installation calls for capital expenditures the allocation of funds to permanent assets Such allocation is expansion

4 ***Integration*** Integration is the addition of facilities or processes ultimately used in the manufacture of the concern s products. Thus a newspaper chain may go into paper making, an automobile manufacturing company may acquire a steel mill, a fruit canning concern may go into orcharding

5 ***Combination*** Any of the above types of expansion may be undertaken within the concern itself or by combining with others It may be easier or more expedient to acquire or become a part of existing concerns, or to form with them a new and larger organization than to create new facilities in competition with them

Motives of Expansion

The motives leading businessmen to expand may be classified under three heads ambition, speculation, and profits

1 ***Ambition*** Personal ambition has at its root the creative impulse, self-expression, the desire for conquest and achievement, and the approval and respect of one s friends, neighbours, and associates

2 ***Speculation*** As many men give vent to their creative impulses and their desires for conquest and achievement, so some like to deal in uncertainties, to apply their imaginations, and to carry the risks of success or failure

3 ***Profits*** Profits from expansion are made possible in several ways These channels may be classified as those pertaining to (a) production, (b) purchase, (c) distribution, (d) administration and (e) finance

(a) *Production Advantages*

(1) Lower material costs and steadier prices by reason of larger purchasing power

(2) Specialization of skilled management

(3) Specialized division of labour
(4) Specialization of plants
(5) Greater possibilities in the introduction of labour-saving machinery
(6) More effective use of by-products
(7) Greater possibilities in experimentations and research
(8) Stabilization of production and reduction of losses from fixed expenses during idleness

(b) *Purchase advantages*

(1) Economics of large scale purchasing
(2) Buying from original source, or ownership of original source
(3) Control of supply of materials

(c) *Marketing advantages*

(1) Larger volume, lower prices and easier selling
(2) More effective use of salesmen, since they represent a larger variety of products
(3) Economical use of advertising media not available to smaller business
(4) Assumption of middleman's function to reduce costs or reach customers more effectively
(5) Transportation economies

(d) *Administrative advantges*

(1) Greater use of statistical and accounting controls
(2) Benefit from intercompany comparisons and exchange of ideas
(3) Greater specialization in administrative departments
(4) Use of higher priced experts because of larger volume of operations to support cost
(5) Greater use of research and testing methods
(6) Centralization of planning for formerly separate units
(7) Lessened labour turnover because of wider variety

(e) *Financial advantages*

(1) More efficient use of funds through co ordination of successive steps in production
(2) Lower cost of funds through better credit and access to the national capital market
(3) Centralized control of cash, credits and collections, and inventories
(4) Stabilization of earnings by balanced production
(5) Reduction or elimination of competition and control of market prices

Disadvantages It is not to be supposed that these advantages automatically accrue to the expanding concern or group Some of them may be offset by certain disadvantages which large-scale operation and combination may involve These are

1 Limitations of executive and managerial ability to control large scale operations effectively
2 Loss of personal contacts as personnel expands
3 Cumbersomeness of production and administration
4 Encouragement to over expansion and over-capitalization.
5 Danger of arousing public hostility and burdensome regulation
6 The possibility of hostile public relations
7 Higher taxes

Sources of Expansion Funds

Irrespective of the economic limitations of expansion, businesses are probably expanded as frequently on the basis of the availability of funds as under any other circumstances Thus expansion is often undertaken in periods of high labour and material costs and high interest rates (periods of prosperity)

Funds for expansion are obtained from one or more of the following sources (1) accumulated surplus, (2) conversion of unnecessary assets, (3) short-term borrowing, (4) sale of bonds, and (5) sale of stock, etc

The usual method adopted by a corporation to expand its operations is through a process of natural growth financed out of earnings or new security floatations Small corporations have little alternative but to finance expansion through retained earnings Larger concerns have the added source of funds obtained from the organized securities markets Growth from within, coupled with that financed by periodic security issues, has the advantage of being of a progressive or evolutionary character This should afford an opportunity to keep financial errors at a minimum

To the desire for speed and for reduction of competition should be added the fact that it may be possible to acquire existing corporations more cheaply than to establish equivalent operations It is, *therefore, not surprising that corporate growth frequently* finds its expression in some form of corporate combination or amalgamation [1]

COMBINATION

Combination is a general term used in the U S A and refers to several types of intercorporate fusion In India, the term *amalgamation is in popular use The Indian Companies Act, 1956* uses the term 'amalgamation', though it does not define it specifically

1 The term 'amalgamation' is sometimes used in the U S A to describe a consolidation In England as also in India the term is synonymous with 'consolidation'

However, according to decisions of courts the term contemplates "a state of things under which two companies are so joined together as to form a third entity or one company is absorbed into and blended with another company " The company which is amalgamated may or may not cease to exist "A company formed by the amalgamation of two companies is in law a legal entity distinct from the two constituent companies Thus, the new company cannot be treated as a successor to the constituent companies e g , for the purpose of Income Tax

Advantages of Combination

1 More minute division of labour—which is usually productive of high efficiency
2 Possible specialization among different plants of the same organization
3 Introduction of machinery and other labour-saving devices which might not be possible with small scale production
4 Expert technical assistance, the cost of which may be spread over a greater number of units of product
5 Production research, the cost of which could not ordinarily be borne by small organizations
6 Ease of control of patents and joint use of the same patents or processes
7 Possibly the profitable utilization of by products In small concerns by products are frequently a waste
8 Spread of administrative expenses which do not ordinarily increase directly with an increase in production over a larger number of units of products
9 Possible large scale purchasing, which is usually productive of savings, not only through lower prices but from lower transportation costs per unit of purchase, and sometimes from less clerical work per unit of product
10 Large-scale marketing, which leads to large sales at small profits per unit of product, to the reduction of selling expenses per unit of product and to national, big-scale advertising
11 Financial advantages through the ease of floating large security issues, and by increases in the turnover of cash and of receivables Borrowing is easier and generally cheaper for large concerns than for small ones
12 Availability of administrative genius to concerns that can afford to pay for it
13 Reduction or elimination of cross freights
14 Discouragement of price cutting
15 Ease of control of customers

16 In some cases corporations combine in order to save the absorbed corporation from embarrassment which might reflect on other concerns in the same field

Disadvantages

1 Bigness leads to extravagance Small expenditures are not watched carefully

2 Details that are important to small concerns are often overlooked in large ones Such details may be found in any department

3 Managerial ability of sufficient calibre to handle aggregates of men, properties, and transactions is difficult to find

4 Public opinion in general does not favour huge enterprises

5 Contrary to general opinion, depressions sometimes affect large enterprises very severely It is not easy for a vast organization to contract

Types of Combination

Combination, of whatever form may be one of three types, or may be a mixure of two or three types

1 *Vertical Combination* When a company expands in order to engage in the production of articles or the furnishing of services essential to the manufacture or distribution of its original line of products, and for which it was formerly dependent upon other firms, it is described as expanding *vertically* In this case the product of one of them is a necessary ingredient or component part of the product of the other For example, a manufacturer of parts may combine with a company that is a supplier of the raw materials of the products it manufactures , a distributing company may expand vertically by securing its own means to manufacture the articles it sells , or a manufacturing company may develop its own distribution outlets and services instead of utilizing independent firms for this purpose Vertical expansion is a popular form and the concerns so formed own or control all of the primary production and distribution facilities or facilities incidental thereto, from extraction or raising of raw materials to the distribution and financing of sales to customers Thus, vertical combination consists of one organization of different undertakings, carrying out successive stages in production, from the raw material to the finished article, or even to the retail sale to the consumer. It aims at securing a position of self-sufficiency one large self-contained and self-supporting unit is formed

2 *Horizontal Combination* A combination is horizontal when two or more organizations engaged in the same or closely related lines or stages of production or distribution are brought together under one management The purpose of such a combination is to eliminate waste and to develop greater economic power

through large-scale production, systematic works specialization, improved methods of distribution, and concentrated research In addition to these advantages, it may, through its increased capital and purchasing power, obtain raw materials more cheaply, and through its influence enter into agreements with other large combines and so still further consolidate its position If the combine is so complete that it constitutes a virtual monopoly it may concert measures to restrict output and fix prices

3 *Circular Combination* The circular or complementary type resembles the horizontal combination It involves the combination of units, either as divisions or subsidiaries, which produce goods that can be distributed through the same channels or by the use of similar methods Prominent examples are General Foods Corporation of the U S A, whose subsidiaries include companies producing beverages breakfast food, baking powder and other foods, and General Motors Corporation, whose divisions and subsidiaries produce and sell air-conditioners, refrigerators and other household appliances as well as automobiles, trucks and accessories The object may be partly to effect economy in overhead expenses and partly to ensure against the failure in demand in any particular trade In some cases this mutual insurance of markets is a dominant motive for circular combination

Methods of Combination

Corporate combinations may be affected in a number of ways that reflect the purpose of the combination and the laws applying to combinations and restraint of trade When the purpose is primarily one of controlling markets and competition, an informal arrangement may be expected On the other hand, when the purpose is primarily one of achieving the economies that may be inherent in a large-scale, integrated operation a formal legal organization will be used The various methods of combination have been classified into three broad categories (1) informal methods, (2) formal methods with separate identities, and (3) outright absorption of separate corporations or merger

I *Informal Co operation*

(i) Gentlemen s Agreement
(ii) Pools, association agreements, and cartels
(iii) Community of interest
(iv) Interlocking Directorates
(v) Purchase and sales contracts

II *Formal Combination*

(i) Trusts
(ii) Holding companies
(iii) Leases

III *Outright Absorption* :

(i) Consolidation

(ii) Merger

I Informal Cooperation

Informal methods are used when the purpose is to restrict competition or when it is desired to obtain an element of co-operative action without formal organization This may be to avoid the financing and other problems involved in formal arrangements, it may be arranged for a temporary purpose

Gentlemen's agreement They are temporary unwritten arrangements which depend for their success upon the willingness of the members to abide by them They are founded upon a mere 'understanding'—usually oral and confidential—between those in control of the participating companies that the companies would act pursuant to a common policy to accomplish certain objectives The usual purpose is to divide markets place limitations on production, maintain or fix prices or similarly restrain competition. This arrangement however, has neither legal sanction nor administrative organization for purposes of enforcement As a result, the participants are prone to violate the agreements whenever it is to their profit to do so They are the weakest of all forms of combination, because under pressure 'gentlemen may cease to be gentlemen' In some cases they are vitiated by unintentional breach owing to the fact that they are subject to misunderstanding. These agreements are almost defunct now

Pool Pools are more formal groupings of competing companies for the purpose of controlling prices, patents, markets, output or earnings through a central organization It is customarily, not necessarily, a written agreement and often confidential in whole or part. It is formally organized and usually has a central administrative agency to which all the members report. In the event of violation, a penalty is imposed and is collected by the central office. Such supervision serves to make the pool slightly more effective than the gentlemen's agreement, but at the same time, no legal means of enforcement are available because the agreements are illegally in restraint of trade As a result, individual members are likely to desert whenever they have an opportunity to make unusual profits The basic weakness of pools stems from a desire to overdo the degree of exploitation.

Pools are classified according to the purpose for which they are formed (1) Production pools (2) Sales pools, (3) Speculation pools, (4) Traffic pools, (5) Territorial pools, (6) Market pools, (7) Patent pools, and (8) Income pools

Cartel is an European term and is similar to the pool The system prevails largely in Germany, Austria, Belgium and other continental countries Some of the powerful cartels are to be found in the pig iron, steel and manufactured metal trades in Germany and

Austria It has been defined as "an association based upon a contractual agreement between enterprises in the same field of business, which, while retaining their legal independence, associate themselves with a view to exerting a monopolistic influence on the market"[1] In a cartel independent undertakings in the same or similar branches of industry come together with a view to improving the conditions of production and sale They are called 'syndicates' where they have set up a common sales organization It is a looser form of industrial combination and allows the different businesses joining the combination to retain a substantial amount of individuality and liberty It does not directly control the management of the different businesses joining it and it does not fix a uniform rate of profit for all those businesses, it generally fixes only uniform selling price for the commodity produced by the different businesses and it also regulates their output* With its looser organization it can be more easily formed and more easily dissolved

Community of Interest By a community of interest is meant the grouping of separate corporations within a sphere of influence through common ownership of stock by one person or a small group of persons who are bound together by common interest and family relationship or long acquaintance This influence may be made more effective by interlocking directorates—that is the same men sitting on the different boards of directors Whether as a result of community of interest or interlocking directorates or both, such a group of companies will work in harmony with one another, since they are either owned or managed by the same persons Such arrangements have played an important part in the development of railroad, industrial and utility combinations and may be almost as effective in concentrating control as a formal device

Interlocking Directorates Whenever the board of directors of two or more corporations have members common to each board, an interlocking directorate exists Although these 'common' members may never carry confidential information between the various boards, they are able to influence the corporations' policies toward united or co-operative action

Unlike the community of interest, interlocking directorates cannot be concealed and, as a result, can be regulated by law Under the Indian Companies Act, 1956 no person can be the director of more than twenty companies at a time The Clayton Act of the U S A prohibits interlocking directorates in large national banks (deposits and net worth of more than $ 5,000,000) or in industrial corporations of over $ 1,000,000 net worth which have been or are competitors of each other Railroads of the U S A may have interlocking directorates only with the approval of the Interstate Commerce Commission and registered public-utility holding companies may have common directors with banks subject to the rules of the Securities and Exchange Commission

[1] N G Guthmann and H E Dougall *Corporate Financial Policy*, 1957, p 543

Purchase and Sales Contract Such contracts may result in co ordinated effort without the relinquishment of corporate identity A company that uses or sells the products of another may enter into an exclusive contract This relation may assure a relatively constant flow of business between the two, may lower production costs, may reduce or eliminate sales effort, and may result in economies One company may become subordinate to the other, and it is not uncommon for the contract to be reinforced by control of one company by the other through stock ownership Many present subsidiaries of motor and steel corporations of the U S A were originally related to the parent company solely through purchase and sales contracts

Less obvious methods have been employed to obtain concerted action by a group of competing corporations *Trade Associations* formed to study such problems as accounting methods, labour relations general research relations with the government, and price policies have led their members to reach agreements that have greatly reduced or eliminated competition in the matter of prices

II Formal Combination

The formal types of combinations involve financial relationships and problems requiring more careful attention.

Trusts The word 'trust' has several meanings, but so far as combinations are concerned, it refers to the device of all or much of the stock of the constituent corporations being transferred by the stockholders to a group of persons known as 'trustees' It signifies a consolidation of capital which is large and strong enough to control the supply and the selling price of the articles with which it deals. The trustees in return issue receipts for the stock. These receipts are known as trust certificates, and they possess all of the characteristics of stock except the right to vote Since the trustees then possess all or much of the stock of the various companies they may control them as one to the extent that they have effective control. The constituent members fuse together their internal management as well as their external affairs relating to market problems in favour of a new unit The control organization decides to a large extent the programme of work and the sales of each participating undertakings Finance is uniformly regulated for all members, surplus and deficiencies being adjusted within the combine The distribution of profits takes place on a common basis

Holding Companies In its broadest sense, a holding company may be defined as 'any corporation which owns the stock of one or more other companies "[1] In the mere generally accepted use of the term, "the holding company is a corporation which owns enough of the voting stock of another corporation (the subsidiary) to have working control over it."[1] A company owned or controlled by another to the extent that it is a mere instrument to carry out the orders of the owning company is called a *subsidiary* and the owning

[1] H G Guthmann and H. E. Dougall *op cit*, p 587

company itself is called the *parent* company The top company, known as the "parent" organization, may be characterized as the "grandfather" or "great grandfather' company, according to the degree of relationship Thus, holding company and subsidiary company are relative terms Under the Indian Companies Act, 1956, a holding company is one which (a) controls the composition of the Board of Directors, or (b) holds more than half the nominal value of the equity share capital of another company The term is usually restricted to two types of organizations—*pure holding companies* and *mixed holding companies* A pure holding company is a non operating company organized for the purpose of investing its capital in the shares of other companies, the affairs of which it undertakes to direct or administer A holding company that is itself an operating company is called a mixed holding company In other words, companies which operate property of their own in addition to controlling other corporations through stock ownership are called *parent* or *holding operating companies* This term is particularly appropriate if the large company has taken the initiative in forming the smaller one Most large companies belong to this group Companies which do not operate properties, but simply direct the operations of their subsidiaries, are called pure holding companies Their assets consist mainly of shares of subsidiaries, and their income is derived from these securities

Advantages of holding company The holding company represents the most flexible device in the entire field of corporation finance Most advantages claimed for combinations that eliminate competition and permit large-scale production apply to holding companies In the holding company form of intercorporate relations there are many conflicting and adverse interests There are the interests of the holding company itself and of its subsidiaries as well as of the stockholders, directors, and officers of each of them In addition, there are the interests of consumers and the general public The advantages listed below are those accruing to the majority of all the interests involved

1 *Flexibility and facility of formation*—The holding company relationship is the least troublesome to create of all the forms of combination The history of the formation of many such companies indicates that combinations formed in this manner have been remarkably free from annoying and difficult litigation by stockholders and creditors

2 *Economy and efficiency of operations*—It can employ high priced experts for advising subsidiaries, furnish them financial assistance, effect savings in quantity purchasing, and the like Sometimes greater efficiency is achieved by placing a number of similar companies, functionally or geographically related, under a sub holding company Managerial, legal, financial and operational efficiencies are possible, while still retaining the separate corporate entities

3 *Ease of acquiring and maintaining control*—The management

of a holding company can obtain at least a degree of control over a firm by the simple expedient of purchasing stock on the open market It is not necessary to obtain permission from the stockholders of either corporation or to reach an agreement with the management of the other company The problems of valuation of assets and earnings, exchange of securities, and handling of non co-operating minority stockholders, are not present

4 *Avoidance of legal impediments*—Use of a subsidiary protects the position of the parent corporation in connection with damage suits or other legal difficulties Damage suits against a subsidiary if won, do not so seriously injure the holding company or its other subsidiaries

5 *Advantages in financing*—In many cases, holding companies have been a major source of funds for the financing of subsidiaries The expansion and integration of public utilities has received a tremendous impetus by the combined financing of holding companies and their operating subsidiaries

6 *Adjustment to local conditions*—Local operating companies are adaptable to local conditions In a country like the U S A having forty-eight states, there are conflicting laws and retaliatory legislation To escape adverse legislation, corporations form subsidiaries in the states having adverse legislation Parent company operates in the states not having it A local corporation can adopt itself to particular conditions and its officers will have authority to act on the basis of their own independent judgment Goodwill of the subsidiary is maintained

7 *Acceleration of 'trading on the equity*—Gaining of control of several subsidiaries through ownership of stock interests will permit an original investment to control a sufficient number of concerns arranged in order on top of one another This pyramiding allows the original capital to be 'stretched' several times , in other words, the 'trading on the equity' may be greatly enhanced Profits may be piled on top of profits

8 *Small amount of capital required*—In order to control the operations of other companies, only the voting stock need be acquired In cases of wide distribution of such stock, a small fraction of these shares is sufficient for a working control A little more than half the voting stock will always give absolute control

In the public utility field, with its extended use of bonds and preferred stock, the equity capital of a holding company can be a minor part of the total investment

9 *Competitive gains* There is increased efficiency throughout the entire industry resulting from the elimination of inter-company competition The more common expenses which are lessened over the industry as a whole will be the decreases in advertising overhead in general, inventories, duplicated equipment, etc As subsidiaries of a single holding company, several small concerns no longer compete ,

instead, they co-operate and even specialize on particular types and varieties of product

10 *Diversity of investment* Through the holding company many fields of operation may be entered, either in the same kind of business or in varieties of businesses In this way material sources may be assured or market outlets be guaranteed The diversification may be made, therefore, to work by spreading risks or by mutually supporting each subsidiary's field of interest Holding companies may engage in as many kinds of business as desired by acquiring control of a sufficient number of companies

11 Tariffs and other obstacles may be overcome by the formation or acquisition of *alien* corporations foreign capital and support may thus be enlisted

12 Subsidiaries may be used to engage in *special departments*

13 A subsidiary may be used to produce a *cheaper* line of merchandise without injuring the reputation of the established product

14 A spirit of healthy *competition* may be set between the various subsidiaries of the system

15 More *officerships* are available than would be the case in a merger or consolidation

16 There may be joint use of patents, of trade name and of other properties

Disadvantages of holding company Foregoing advantages suggest the use of the holding company device in the development of large-scale industry in all fields of concentration , yet it also has certain inherent disadvantages that have caused many firms to seek other methods of control over their expansion and subsequent operation Some of the more important disadvantages are

1 *Duplication of taxes*—In addition to the taxes payable by separate corporate entities the parent company has to pay tax on the income received as dividends declared by a subsidiary More over, every corporation must pay a state franchise tax Thus there is certain amount of duplication of taxes

2 *Costly organization*—The maintenance of separate corporate organization is a costly process involving administrative overhead that a smaller business cannot afford and it may sometimes become irksome to a larger company Preservation of separate corporate existence of subsidiaries results in the loss of some benefits available to other forms of combination

3 *Complexity of structure*—There is tendency for the structure to become complex resulting in the difficulties of supervision and management This opens the way for frauds, excesses, abuses and economic losses An unsound and unnecessarily complicated capital structure of subsidiaries is usually accompanied by unsoundness of financial structure

4 *Management control*—In a holding company the subsidi-

aries are far removed from the parent organization. The officers thus acquire a degree of independence and autonomy not always conducive to co-operative action.

5. *Decentralization and inefficiency*—Decentralization in the holding company, as contrasted with centralization in the merger or consolidation, does not always prove economical or efficient.

6. *Difficulty of dissolution*—Dissolution of one or more of the subsidiaries is sometimes very difficult, especially if there are minority interests to consider.

7. *Manipulation*—The creditors and minority stockholders of subsidiary companies may suffer on account of manipulation and 'upstream loans' (loans made by subsidiaries to the holding company at times when the subsidiaries can ill-afford them). There may be excessive dividend payments by subsidiaries to bolster the holding company's cash income. The creditors may also lose by the diversion of one subsidiary's business to another.

8. *Disadvantages to consumers*—The holding company may put the consumers to loss by interference with local prices of products and by diversion of the local subsidiary's funds to other localities and through loss of local management.

Abuses of holding company The holding company form of combination is peculiarly susceptible to the introduction of abuses both in its formation and operations. Properly utilized the device is sound and economically and socially justified. But it has not been always so used. A few of the flagrant abuses are:

1. *Disenfranchisement*—In order to control extensive properties, the holding companies tend to raise capital by means of bonds and preference shares, resulting in equitable distribution of voting power among security holders. Thus persons with the greatest investment and practically the sole interest in the soundness of the subsidiary are deprived of a voice in management.

2. *'Fair weather' capital structures*—The unsoundness of top-heavy, over-capitalized, debt-burdened holding companies and producing and operating companies make them unable to withstand any considerable change in earning abilities. As a result, defaults, reorganizations, and bankruptcies, with heavy losses to investors, often follow. Sound capital structures are often sacrificed for the sole benefit of the holding company.

3. *Draining of assets and earnings*—By the use of unjustified interest bearing loans to dependent companies, the holding company sometimes procure income for itself even when the borrowing company is in arrears of preference dividends. Or it can divert funds by inter-company transactions from one subsidiary to another. It can also overcharge for its specialized services in engineering, finance, or management.

4. *Manipulation of accounts*—By manipulation of accounts, especially of depreciation and reserves, the holding companies distort income and asset figures and drain off funds through unwarranted

dividend payments The usual method employed is to "write-up" or inflate the assets of subsidiaries and sell securities on the basis of the "watered" values

5 *Concentration of economic power*—The uneconomic combination of unrelated properties under absentee controls and speculation in securities, often diminishes the nation's productive facilities and results in huge public losses

6 *Evasion of government supervision and regulations*—The holding companies become powerful instruments of evading government supervision and regulations

7 *Excessive rates to consumers*—The financial practices and manipulations of holding companies have often prevented price or rate reductions to consumers

8 *Reduction of taxation*—The holding company device is frequently used as a method of limiting taxes in countries like the U S A where corporations are not fixed uniformly in all states The device is the maintenance of sickly subsidiaries, i e , the losses of the subsidiaries offsetting the profits of the parent concerns

9 *Dissipation of goodwill*—In the creation of a great holding company through the absorption of numerous subsidiaries, the proper treatment of goodwill is extremely difficult If company A is acquired by B, it does not follow that A's goodwill remains the same , it may increase, but it is more likely to decrease

Leases The lease is also used as an alternative to other means of combining whole properties A lease contract is essentially an agreement under which the owner (landlord or lessor) transfers the possession of some or all of his property to the user (tenant or lessee) in return for the payment of rent Here the entire operating assets of one company are leased to another for a long period of time The lessor corporation becomes a mere shell, collecting the rental and distributing it to its creditors and owners Such long-term leases involving the entire assets of the lessor require the consent of its shareholders The lessee agrees to pay all operating expenses and taxes and a stipulated rental for the use of the properties The rental often consists of a sum sufficient to cover interest on any bonds of the lessor and a fixed return on its stock, together with a sum sufficient to cover the running expenses of administering the dormant non-operating lessor corporation such as office expenses, corporation franchise taxes and the like

A lease contract may be for a short period of one to five years or it may be for a very long period of 50 or 100 years (999 years is common among railroads) It is an important device of affecting combination in the railroad industry of the U S A where in 1951 as much as 11% of the railroad mileage was owned by lessor companies Lease is seldom used by industrial companies to affect combinations, save for the occasional use by extractive and chain organizations

III Outright Absorption

The bringing of two or more companies into a common and

single organization may be accomplished either by the enlargement of an existing concern or by the creation of a new corporation Under the first plan, one existing company expands its capitalization, obtains the outstanding securities of the other companies by giving its own in exchange, and then usually arranges for the dissolution of corporate identities of the merged companies Under the second arrangement, a new corporation is organized to take over all the individual concerns involved, after which the process of exchanging securities and the dissolution of the separate corporate entities are about the same as in other procedure Technically, the first method is known as a 'merger and the second as a 'consolidation'

Consolidation A complete union of two or more companies into one new company is called a consolidation The uniting corporations are voluntarily extinguished according to a plan approved by the shareholders and the new entity takes over all of their properties, liabilities, and non-dissenting shareholders remaining upon execution of the plan

Merger When one or more corporations are fused into one already in existence, the result is called a merger Upon the agreement of merger becoming effective, after approval by the shareholders, the separate existence of the company acquired ceases and acquiring corporation succeeds to all rights and property of the corporation acquired and becomes subject to all of its debts, liabilities and duties

In a merger there is usually the exchange shares or the stock After all the shares of the absorbed company are acquired, the latter is dissolved and the result is one larger acquiring company retaining its own identity

In a consolidation, it is necessary to form a new corporation, to obtain a new charter , in a merger the combination takes life under the charter of the acquiring corporation It may or may not be essential, in a merger, to obtain an amendment of the charter of acquiring corporation, but it is not necessary to obtain a new one In a merger the identity of at least one of the constituent corporations is retained In a consolidation a new identity is created As in the case of a merger, the basis of combination is usually an exchange of stock In the case of the merger, only the absorbed company (or companies) is dissolved after the exchange In the case of the consolidation all of the absorbed companies are dissolved

Other forms of Combination

In addition to the varieties of combination outlined above, certain special types are worthy of note These are not combinations in the same sense as those outlined above, but are combinations for special purposes only They are (1) Trade associations, (2) Voluntary chains, (3) Group buying associations, (4) Joint advertises, (5) Cooperatives, and (6) Export associations, etc

Motives for consolidation and merger. Broadly speaking, there are two important motives behind consolidation and merger (1) Alert management, and (2) Elimination of competition

Alert management—In any industry the quality of management in the various concerns varies greatly at any given time Some companies have alert heads of management who are very active in making progress, others are simply content to hold their place Alert managements may acquire existing business units in no time and without any risks of construction There may also be substantial possibilities of eliminating duplication of overhead sales organization, advertising warehouse stocks etc, by consolidation or merger of several companies The concern may be able to add substantially to the percentage of return on owned capital by taking over other companies The expenses of developing new business are largely eliminated by consolidation and merger The control of prices is made more certain and more effective through market control and absorption of competing concerns

Elimination of competition Other motives for consolidation and merger are applicable to special circumstances of each case They are (1) elimination of competitive expenses, such as advertising, duplicate stocks of goods, duplicate machinery and equipment, direct selling expenses general overhead costs, etc of concerns engaged in the same line of activity or in the creation of substitute goods, (2) advantages of size through greater division of labour and purchase of raw materials, etc (3) control over prices and markets, (4) pooling of patents copyrights franchise and other privileges of a monopolistic nature (5) absorption of competing goods producers (a manufacturer of a typewriter may discover serious reductions in the sale of his own machine as a result of the issue of a patent to small competing concern and it may be cheaper to buy the company outright than either to buy the patent or to suffer the future losses on operations without the use of the patent), (6) to attract adequate public response for future financing, (7) to secure geographical plant specialization

Methods of consolidation. Consolidations do not happen as a matter of course, they are result of arduous efforts and untiring zeal of certain individuals or groups of individuals There is also no single well-defined method available for the purpose, every consolidation differs from every other Yet, there are a few clearly defined avenues of operation to arrange consolidations The simplest way to bring about a consolidation in the average corporation is to arrange through the officers and directors of the company for a purchase of its assets or its shares

Whether to effect a merger, consolidation, sale of assets, or holding company arrangement, shares are often exchanged between the various interested parties In practice the factors involved may be (1) the market value of the shares of the represented companies, (2) the market value of their properties, (3) the earning power of the several companies, (4) the bargaining power of the various parties,

(5) legal considerations of domicile, control, etc, or any or all of these The well known methods employed are three They are (1) the Scientific method, (2) the Bargaining method, and (3) the Option method

The Scientific method emphasizes the value of assets and earning power Tangible assets are usually paid for in preference shares; excess earning power in ordinary shares The chief problems of this method lie in the appraisal of assets

The valuation proceeds on the analogy that a constituent has two distinct things to contribute to a consolidation, namely, assets and earning power It entails (1) determining the capitalization of the consolidated company by capitalizing earnings, and (2) distributing the securities among constituent companies according to a formula for evaluation of assets and earning power

When this plan is followed, the constituent companies simply decide that all tangible assets shall be paid for in preference shares at par and that the excess earning power shall be paid for in ordinary shares The excess earning power is usually called intangible assets or goodwill and is found by subtracting from the capitalized earning power the amount of tangible assets If the tangible assets amount to Rs 1,00,000 *and the net earnings to* Rs 25,000 a year, and 10% is considered a fair rate at which to capitalize the earnings, the capitalized earnings will be Rs 2,50,000 and the excess capitalized earnings will be Rs 2,50,000 less the amount of tangible assets (Rs 1,00,000), or Rs 1,50,000 This company would, therefore, have Rs 1,00,000 of preference shares and Rs 1,50,000 ordinary shares

It does not provide a hard and fast division of shares It simply implies a principle, namely, that some allowance will be made for tangible assets in preference shares and some allowance will be made for earning power in ordinary shares But what allowance shall be made in any given case is a matter for the parties to negotiate

The Bargaining method emphasizes earning power and the estimated savings of the proposed combination It is called the bargaining method because the amount to be allotted to each constituent company depends on the importance of the constituent's assets and earnings, and because it allows wide powers of bargaining to the promoter

In this method, the promoter estimates the total earnings after consolidation To the present actual earnings he adds the anticipated savings of consolidation The total is then capitalized at a fair rate He then negotiates with the various companies so that a portion of the securities is left for him, as compensation for his promotional services This method is also called the Morgan method after one of its most successful exponents

Some authors[1] call this the *negotiated exchange method* since

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1 F F Burt Chett and C. M Hicks *Corporation Finance*, 1948, p 556

the basis of the exchange of shares is to be determined between the parties to the consolidation by elaborate negotiations The promoter of the consolidation approaches the officers and directors of the corporations to be consolidated, and negotiates directly for the exchange of shares Brokers may represent one or both of the parties, or the sale of assets may be negotiated by an investment banker, an attorney, or a consultant representing either corporation The interested corporation furnishes the corporation proposing the merger with financial statements and other data necessary to work out the deal If the shares of the acquiring corporation and of the corporation to be absorbed have clearly established market price, it is easy to arrive at an equitable basis for effecting an exchange of securities But if the shares of the corporation that is to be absorbed are not bought and sold on a stock exchange or over the-counter, those who are negotiating the deal must determine the relative values of the shares of both corporations by bargaining and must arrive at a basis for an exchange of shares that will meet with the shareholders' approval When an agreement is reached as to an equitable basis for the exchange of shares, a prospectus of the proposed exchange is drawn up The plan is then submitted to the shareholders at a special meeting, and if approved by the officers, a few large share holders and some bankers, will generally be approved by the share-holders to implement the deal The success of the exchange method is conditioned by the attractiveness of the exchange ratio It is, therefore, not uncommon to make special provisions for non-assenting shares, i e , payment in cash at appraised values, or court procedure to secure their value

The Option method is so called because by this plan the promoter first obtains from the constituents options to purchase their assets Since the promoter does not ordinarily possess sufficient cash to take up the options, he then generally forms a syndicate to furnish the same, and the holders of the properties are offered securities of the acquiring company in lieu of cash Should they not accept such securities, the syndicate pays the cash and takes the securities The promoter carries great risks under this plan This method is also called the Flint plan because this was frequently and successfully used by Charles R Flint of the U S A

Under this method, the approach may be either through shares or through assets If the shares are owned by a small number of holders, negotiations are carried on directly with these holders, individually or in a group If the shares are widely distributed, the first move may be to secure a deposit of the shares with a 'consolidated committee" or a syndicate, which will negotiate the shares as a unit If the option to purchase is secured, further calculations may be made to determine if the option is worth anything and how the funds will be raised to exercise it The option device permits financing on the part of the acquiring corporation after the basis of consolidation is known If temporary borrowing has been used, refunding may be carried out directly the options are exercised

This method does not require capital to be tied up in the consolidation process for long

Combinations in India

Combinations in India have not assumed such large proportions as in Western countries In fact, combination movement is not a great problem in this country The reasons for the slow growth of the combination movement are many Firstly, industrially India is still backward With the exception of a few solitary cases, industries in India have not reached a stage when combinations are necessay Secondly, our industrial leaders have generally adopted an individualistic attitude in regard to combination Thirdly, the managing agency system has, in many cases, provided the economies of combination by means of group management of industrial units Till the passing of the Indian Companies Act, 1956, there were as many as 50 companies integrated under the managerial control of a single managing agency [1] These managing agents provided not only managerial integration, but also administrative and financial one The managing agency system, however, is fast declining as a result of the policy of gradual elimination adopted since 1956 or is being abolished from certain fields of business and industry The country is also taking strides in the fields of industry, trade and business *There is a move afoot to strengthen the industrial structure of the country through the elimination of uneconomic or marginal units and concerns of old established industries of the country There may, therefore, be need to accelerate the pace of combination movement* in the country Some important examples of amalgamation in the insurance and banking are given here

1 *Life Insurance Corporation of India*—In the field of finance a very important amalgamation is the formation of state owned concern, the Life Insurance Corporation of India It came into existence on September 1, 1956 under the Life Insurance Corporation Act, 1956 The Corporation took over all the assets and liabilities appertaining to the controlled business of 245 insurance companies, including three State Insurance Departments Now, the L I C is a large organization with its offices spread over the entire length and breadth of the country

2. *Banking companies*—A striking feature of the banking system in India until recently was that it consisted of a large number of small banks, which, however, accounted for a very small part of the banking business in the country These banks operated mostly in the south, particularly in the States of Madras and Kerala Their activities were generally limited to one district and in view of their

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[1] This managerial integration was at its zenith in 1950 when Messrs Andrew Yule managed 50 companies MacLeod 40 companies Juggilal Kamlapat 42, Dalmia 38 companies (T R Sharma and S D Singh Chauhan. *Indian Industries*, 1966, pp 166 67)

limited resources they confined their business mostly to small traders and individuals Many of these banks were uneconomic units whose working showed basic weaknesses such as low liquidity position, over-capitalization, over-extended advances portfolio, large advances on clean basis, etc Since the enactment of the Banking Regulation Act, 1949 the Reserve Bank has been endeavouring to improve the methods of operation of such banks through periodical inspections and issue of directions Banks which could not improve their financial position and methods of operations in spite of repeated advice and guidance were closed down through refusal of licences Though 135 banks (of which 2 were scheduled banks) were closed in this way during the period since the commencement of the Banking Regulation Act till the end of 1960, many sub-standard banks continued to exist side by side with sound units

Amalgamation or transfer of business of unsound units to other banks is recognized as one method of correcting weaknesses in the banking structure Till September 1960 the Banking Regulation Act, 1949 (Section 44A) had provided for the amalgamation of banks only on a voluntary basis, a banking company could also transfer its assets and liabilities to another banking company under Section 293 (1) (a) of the Companies Act Though the policy of the Reserve Bank was to encourage mergers, it could not play an active role in this regard as the initiative for such mergers had to come from banks themselves As a result such mergers were very few until 1960 The failure of two scheduled banks, viz, the Palai Central Bank and the Laxmi Bank in 1960, served to emphasize the need for arming the Reserve Bank with powers to bring about compulsory amalgamation or reconstruction of banks as an alternative to the lengthy and costly process of liquidation Accordingly, the Banking Regulation Act, 1949 was amended in September 1960 The Banking Regulation (Second Amendment) Act, 1960 empowered the Reserve Bank to apply to the Central Government for the grant of moratorium to banks where circumstances necessitated such action During the period of moratorium the Reserve Bank may frame schemes for their compulsory amalgamation or reconstruction which on sanction by the Central Government would come into force on a specified date

Under the provisions of the amended Act, the 188 banks which had 936 offices were taken over by 53 banks between 1960-65 Of the 187 Indian transferor banks (one was foreign transferor bank) 16 were scheduled banks having 362 offices Merger by way of transfer of assets and liabilities was the most common method and was adopted by as many as 111 banks as it involved the least amount of legal formalities Although banks were not required to obtain permission of the Reserve Bank for transfers of assets and liabilities, they generally took the Reserve Bank's advice in the matter of merger.

Method of Merger	*1960*	*1961*	*1962*	*1963*	*1964*	*1965*	*Total*
1. Voluntary amalgamation u/s 44A of Banking Reg. Act, 1949	2	1	3	2	7	5	20
2. Compulsory mergers u/s 45 of Banking Reg. Act, 1949	—	30	1	1	9	4	45
3. Mergers u/s 35 of State Bank of India Act and Sec. 38 of the State Bank of India (Subsidiary Banks) Act	—	2	2	4	1	3	12
4. Transfer of assets and liabilities u/s 293 (1) (a) of Companies Act, 1956	5	3	5	15	62	21	111
Total	7	36	11	22	79	33	188

Of 187 mergers of Indian banks, 20 mergers took place in the public sector; 12 of these were mergers of the State-associated banks merged on a voluntary basis under the State Bank of India Act and the State Bank of India (Subsidiary Banks) Act. With the acquisition of the Dewas Senior Bank by the State Bank of Indore on March 20, 1965 the process of integration of minor State-associated banks with the State Bank of India and its subsidiaries was almost completed.

There were 45 compulsory amalgamations brought about under Section 45 of the Banking Regulation Act, the largest number of compulsory amalgamations (30) having taken place in 1951. In the subsequent two years there were only 2 compulsory amalgamations, one in each year. In 1964 there were as many as nine amalgamations on a compulsory basis while in 1965 there was a slowing down in the pace of amalgamations and only four banks were amalgamated by resorting to the provisions of Section 45 of the Banking Regulation Act.

Modes of Amalgamation

Two or more companies can amalgamate in either of the two ways. (1) company A can sell its business and undertaking to company B in consideration of shares in company B. Company A then goes into liquidation and distributes the shares in company B amongst its shareholders and the result of it all is that whereas there were previously two corporations, A and B, the corporation A has now merged in corporation B. There is only one corporation carrying on one undertaking with one set of shareholders. (2) Another way in which amalgamation is frequently done is that a third company C is formed and both the companies A and B sell their undertakings to company C in consideration of shares in under

taking C The shares in A and B are then distributed amongst the shareholders by means of liquidation and the companies A and B cease to exist As a result of the transaction, there is now a new corporation C in place of the former corporations A and B There is one set of shareholders instead of two sets of shareholders, and one undertaking instead of two undertakings

There are *five* methods of amalgamation prescribed under the Indian Companies Act

(1) *By transfer of the undertaking* of one company to another An agreement to sell the undertaking of one company to another is entered into between the two companies The scheme contained in the agreement is a form of compromise or arrangement The scheme needs the sanction of the court Accordingly an application is made to the court for its sanction If the court sanctions the scheme it is executed without formally taking the company into liquidation

(2) *By transfer of shares* of one company to another In this case the transferee company prepares a scheme and offers it to the transferor company for the approval of the shareholders of the latter company Thus, there is a voluntary transfer of shares of one company to another and there is no necessity of compulsory approval to the court If the scheme is not an appealing one, it can be turned down by the shareholders

(3) *Amalgamation in public interest*—If it is essential in the public interest that two or more companies should amalgamate, the Central Government has the power to order amalgamation of those companies into a single unit by a notification in the Official Gazette with such constitution, such property powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations, as may be specified in the order

(4) *Under members' voluntary winding up*—A company which has already gone into liquidation can, by a special resolution confer rights on the liquidator to accept shares, policies or other like interests in the transferee company for distribution among the members of the transferor company, or enter into other arrangement whereby the members of the transferor company may participate in the profits of the transferee company

(5) *Under creditors' voluntary winding up*—A company under creditors' voluntary winding up can also empower the liquidator to accept amalgamation but the liquidator must exercise his powers with the sanction either of the court or of the Committee of Inspection

Procedure of Amalgamation

A company is a legal entity, it is created by law, it carries on its affairs according to law throughout its life and ultimately it is effaced by law Since amalgamation involves ending the life of the transferor company, a resort to legal proceedings prescribed by law

is essential The amalgamation of any two or more companies under the Indian Companies Act is a part of the compromise or arrangement between a company and its members or its creditors For the purpose of any compromise or arrangement, the intervention of the court is essential[1] If the court is approached by a company, its members or its creditors, the court supervises the compromise The court orders convening of meetings of the members or the creditors, as the case may be If a majority of three-fourths agrees to the scheme of compromise, the court has good ground to accord sanction of the scheme if it considers the scheme conducive to public interest and commercial morality A scheme which has been approved by the court is binding on the parties and can be implemented without difficulty

A few examples of Amalgamation

(1) *The British India Corporation Ltd*—The earliest and a very notable instance of amalgamation in India is that of the British India Corporation The Corporation was registered as a limited company on the 24th February 1920 with the specific object of combining and amalgamating, under one Board of Directors, the following businesses with effect from the 1st January 1920.

(i) Kanpur Woollen Mills Co, Ltd, Sole Manufacturers of the well known "Lalimli" brand of all-wool, pure wool materials, Kanpur (established 1876)

(ii) Cooper Allen & Co Ltd., Proprietors of the largest Army Boot and Equipment Factory in the world, Kanpur (established 1881)

(iii) North-West Tannery Co Ltd, Proprietors of the largest and most up to-date Tannery in the East, Kanpur (established 1881)

(iv) New Egerton Woollen Mills Co Ltd, Sole Manufacturers of the celebrated "Dhariwal" Long Life Wool Wear, Dhariwal, Punjab (established 1882)

(v) Kanpur Cotton Mills Co Ltd, Sole Manufacturers of the unsurpassed 'Kakomi" Cotton Yarns and Fabrics, Kanpur (established 1882)

(vi) Empire Engineering Co Ltd, Civil, Mechanical, Motor and Constructional Engineers, Contractors and Builders, Kanpur (established 1894)

For many years, most of these concerns had been run as a group and co-ordination had been secured by an interlocking of capital, but in the interests of all concerned, the time was considered appropriate for giving greater security and permanence to the bonds of union To attain this, the companies then existing were wound up and there were issued to the shareholders of these companies, shares in the British India Corporation Ltd, in proportion to the

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1 Detailed procedure is discussed in Chapter 18 on 'Reorganization and Reconstruction'

valuations of the respective businesses These valuations were based on the pre war (i e 1914) costs as regards Block, and, as to Investments, which were then comprised of high class securities only, at substantially less than the market values at 31st December, 1919 while Stock-in-Trade and Stores were valued on the conservative lines followed by the companies amalgamating The managerial arrangements existing in the amalgamating companies were at that time left undisturbed

(2) *The Associated Cement Companies Ltd*—A very important case of amalgamation is that of the Associated Cement Companies Ltd It was formed in 1937 in order to amalgamate eleven cement manufacturing concerns which went into voluntary liquidation Technical Experts went round to the various factories and fixed a valuation for the properties of the individual companies

On the basis of the valuation made by the Technical Experts, an uniform rate per ton of manufacturing capacity was fixed by way of purchase consideration The total purchase consideration was thereafter arrived at However, as the various manufacturing units belonging to the Merging Companies were not of the same age, the cost of the newest factory was taken as the basis for comparison, and what were called "efficiency penalties" were levied on the Merging Companies, and these were satisfied by payment in cash The total purchase consideration payable to each merging company was satisfied by the issue of fully-paid shares and fractional certificates The merging companies also provided working capital for the A C C. by taking up shares for cash consideration in proportion to their manufacturing capacity

Ordinarily, the Shares and Fractional Certificates would have been transferred into the name of each liquidator However, to facilitate distribution, the liquidators of the merging companies were asked to give a list of shareholders of each company, so that the distribution of Shares and Fractional Certificates could be made direct to the shareholders This was done and a time limit was fixed within which a certain number of Fractional Certificates constituting whole shares, were to be submitted to the A C C for conversion into whole shares

The above procedure was adopted for distribution so as to enable the A C C to bring all the shareholders of the merging companies on its Register of Members

All the merging companies went into liquidation

(3) *IISCO-SCOB Merger*—The biggest and the most unique merger is that of the Indian Iron & Steel Co Ltd , and The Steel Corporation of Bengal Ltd This merger was effected in January 1953, not under the provisions of the Companies Act, but by means of a special Ordinance promulgated by the President of India in October 1952 We give below the full details of the Ordinance as well as the Report on the Fair Ratio between shares of the two merging companies depicting the circumstances, reasons and procedure, etc , of the merger

THE IRON AND STEEL COMPANIES AMALGAMATION ORDINANCE, 1952[1]

No VIII of 1952

An Ordinance to make special provision, in the interests of the general public and the Union, for the amalgamation of certain companies closely connected with each other in the manufacture and production of iron and steel, and for matters connected therewith or incidental thereto

Whereas for the purpose of securing, in the interests of the general public and the Union, the efficient and economical expansion and working of the iron and steel industry in India, it is essential that the Steel Corporation of Bengal, Limited, and the Indian Iron and Steel Company, Limited, which are engaged in the manufacture and production of iron and steel, should be amalgamated ;

And whereas to give effect to the scheme of the Central Government for the expansion of the iron and steel industry and to make available further resources for such expansion, it is necessary that the said companies should be amalgamated with as little delay as possible ,

And whereas the amalgamation of the said companies is also in pursuance of successive recommendations made by the Tariff Board and the Tariff Commission ,

And whereas Parliament is not in session and the President is satisfied that circumstances exist which render it necessary for him to take immediate action ,

Now, therefore, in exercise of the powers conferred by clause (1) of article 123 of the Constitution, the President is pleased to promulgate the following Ordinance

1. ***Short title and commencement.*** (1) This ordinance may be called the Iron and Steel Companies Amalgamation Ordinance, 1952

(2) It shall come into force at once.

2 ***Definitions*** In this Ordinance, unless the context otherwise requires,—

(*a*) "appointed day" means the 1st day of January, 1953 ;

(*b*) "the dissolved company" means the Steel Corporation of Bengal, Limited, formed and registered under the Indian Companies Act, 1913 (VII of 1913) ;

(*c*) "the Iron and Steel Company" means the Indian Iron and Steel Company, Limited, formed and registered under the Indian Companies Act, 1913 (VII of 1913) ;

(*d*) "prescribed" means prescribed by rules made under this Ordinance.

3. ***Amalgamation of certain companies engaged in the iron and steel industry.*** (1) As from the appointed day, the under-

1 The ordinance was later on converted into an Act of Parliament.

taking of the Steel Corporation of Bengal, Limited, shall be transferred to and shall vest in the Iron and Steel Company

(2) The undertaking of the dissolved company shall be deemed to include all rights, powers, authorities and privileges and all property, movable or immovable, including cash balances, reserves, revenue balances, investments and all other interests and rights in or arising out of such property as may belong to, or be in the possession of, the dissolved company immediately before the appointed day, and all books, accounts and documents relating thereto, and shall also be deemed to include all debts, liabilities and obligations of whatever kind then existing of the dissolved company

4 ***Special provision for the transfer of certain items of property.*** For the purposes of this Ordinance, all the profits of the dissolved company for the year 1952 and the revenue reserves of the dissolved company, when transferred to the Iron and Steel Company under the provisions of this Ordinance, shall be deemed to be respectively the profits of the Iron and Steel Company for the said year and revenue reserves of the said company

Provided that nothing in this section shall entitle a director or a managing agent of the Iron and Steel Company to any commission or other remuneration in respect of any profits so transferred

5 ***Saving of contracts, etc , to which the dissolved company is a party*** Subject to the other provisions contained in this Ordinance, all contracts, deeds, bonds, agreements and other instruments of whatever nature to which the dissolved company is a party, subsisting or having effect immediately before the appointed day, shall be of as full force and effect against or in favour of the Iron and Steel Company, as the case may be, and may be enforced as fully and effectually as if, instead of the dissolved company, the Iron and Steel Company had been a party thereto

6 ***Saving of legal proceedings to which the dissolved company is a party*** If, on the appointed day, any suit, appeal or other legal proceeding of whatever nature by or against the dissolved company is pending, the same shall not abate, be discontinued or be in any way prejudicially affected by reason of the transfer to the Iron and Steel Company of the undertaking of the dissolved company or of anything contained in this Ordinance, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the Iron and Steel Company, in the same manner and to the same extent as it would or may be continued, prosecuted and enforced by or against the dissolved company if this Ordinance had not been promulgated

7 ***Terms of transfer as respects shareholders in the dissolved company*** (1) As soon as may be after the appointed day, the Iron and Steel Company shall, subject to the rules, if any, made in this behalf, allot to every person registered as a shareholder in the dissolved company immediately before the appointed day,—

(*a*) if he is the holder of preference shares, as many preference

shares in the Iron and Steel Company as are equivalent in number and value to the preference shares held by him in the dissolved company immediately before the apppointed day, and

(*b*) if he is the holder of ordinary shares, four ordinary shares for rupees ten each in the Iron and Steel Company for every five ordinary shares for rupees ten each held by him in the dissolved company immediately before the appointed day, being the relative values of the two shares as determined by the Tariff Commission established under the Tariff Commission Act, 1951 (L of 1951)

(2) Notwithstanding anything contained in any other law for the time being in force, any report made by the Tariff Commission before the commencement of this Ordinance respecting the value of ordinary shares in the Iron and Steel Company in relation to the value of ordinary shares in the dissolved company shall be deemed to have been validly made and shall not be called in question in any court

(3) Every shareholder in the dissolved company to whom a preference share has been allotted under this section shall be entitled—

(*i*) to receive a fixed cumulative preferential dividend at the rate of five *per cent per annum* as from the 1st day of January, 1953, on the capital for the time being paid up or credited as having been fully paid-up thereon without deduction of Indian income tax paid by the company ,

(*ii*) Subject to the provisions of clause (*i*), to rank for dividend equally with the holders of preference shares in the Iron and Steel Company immediately before the appointed day, and in priority to all other shareholders in that company ,

(*iii*) to be repaid, in the winding up of the Iron and Steel Company, the amounts paid up or credited as having been fully paid up thereon, together with any arrears of dividends (whether earned or not), calculated to the date of repayment of capital, equally with the holders of preference shares in the Iron and Steel Company immediately before the appointed day, and in priority to all other shareholders in that company ,

(*iv*) to exercise the same voting rights at general meetings of the Iron and Steel Company as are conferred on the holders of preference shares in that company immediately before the appointed day

(4) The Iron and Steel Company shall cause a notice to be published in the *Gazette of India* and shall also send by post to every person whose name was entered immediately before the appointed day in the register of shareholders in the dissolved company, a notice giving particulars of the terms hereinbefore set out as to the allotment of new shares and the disposal in the prescribed manner of fractional shares and an allotment letter for the new shares which shall also contain a statement of the fractional shares

(if any) to which a shareholder would be entitled if fractional shares are to be allotted

(5) Every shareholder in the dissolved company whose name appears in the register of the dissolved company immediately before the appointed day shall be entitled on presentation within the prescribed period of the allotment letter and the share certificate in respect of the shares held by him in the dissolved company to receive in due course share certificates of the Iron and Steel Company in accordance with the provisions of this Ordinance and the rules made thereunder

(6) Any rights specified in sub section (5) shall during the period beginning with the appointed day and ending with the day on which the Iron and Steel Company issues fresh share certificates to the shareholders of the dissolved company be transferable in like manner as the shares in the Iron and Steel Company themselves are transferable and the transferees of such rights shall be entitled upon submission of the letter of allotment the relative share certificate in the dissolved Company and the document of transfer to share certificates in the same manner and to the same extent as the transferors would have been entitled

8 ***Priority as between secured creditors of the dissolved company and secured creditors of the Iron and Steel Company*** Creditors of the dissolved company whose debts are secured by a mortgage charge or lien on the property of the dissolved company or any part thereof shall with reference to similar secured creditors of the Iron and Steel Company have such priority in the repayment of the debts as may be determined by agreement between the Iron and Steel Company and the secured creditors of the dissolved company

Provided that in the absence of any such agreement the matter shall be referred by the Iron and Steel Company to the determination of such person as may be appointed by the Central Government in this behalf and the decision of such person shall be final and binding on the Iron and Steel Company and the secured creditors concerned

9 ***Provisions with respect to taxation*** (1) The Iron and Steel Company shall be taxable in respect of the profits and gains of the business carried on by the dissolved company before the appointed day to the same extent as the d ssolved company would have been taxable if this Ordinance had not been promulgated and the Iron and Steel Company shall in its assessment be entitled to claim all such allowances under sub section (2) of section 10 of the Indian Income Tax Act 1922 (XI of 1922) as the dissolved company could have claimed in its assessment if this Ordinance had not been promulgated

(2) For the purposes of any law relating to taxation on income the original cost to the Iron and Steel Company of the buildings machinery plant or furniture of the dissolved company transferred to it by virtue of this Ordinance shall be deemed to be the written down value thereof as reduced by the initial depreciation permitted

by sub-section (2) of section 10 of the Indian Income-Tax Act, 1922 (XI of 1922), which has been or could have been computed by the dissolved company on the appointed day if this Ordinance had not been promulgated

10. ***Payment of interim dividends to shareholders in the dissolved company*** If the profits of the dissolved company warrant such a course, the directors of the dissolved company may, at any time before the appointed day, declare the following dividends as being payable,—

(*a*) to the holders of preference shares immediately before the appointed day, a dividend at the rate of *5 per cent per annum* on the amount paid-up without deduction of Indian income-tax payable by the dissolved company for the period commencing on the 1st day of June, 1952, and ending with the 31st day of December, 1952:

(*b*) to the holders of ordinary shares whose names appear on the register of the company on the date of such payment, an *interim* dividend not exceeding two and a half *per cent* on the amount paid-up or credited as having been fully paid-up thereon without deduction of Indian income-tax payable by the dissolved company for the period commencing on the 1st day of January, 1952 and ending with the 31st day of December, 1952.

11 ***Provisions respecting existing officers and other servants of the dissolved company.*** Every officer or other servant (including within that expression auditors but excluding therefrom directors, managing agents and London Committee Members) employed immediately before the appointed day in the dissolved company shall, as from the appointed day, become an officer or other servant, as the case may be, of the Iron and Steel Company and shall hold his office or service therein by the same tenure and upon the same terms and conditions and with the same rights and privileges as to pension or gratuity as he would have held the same under the dissolved company if this Ordinance had not been promulgated, and shall continue to do so unless and until he is duly removed from his employment in the Iron and Steel Company or until his terms and conditions of employment are duly altered by that Company.

12. ***Position of directors of the dissolved company.*** Every director of the dissolved company holding office as such immediately before the appointed day shall become, as from the appointed day, a director of the Iron and Steel Company, in addition to the other directors of the Iron and Steel Company holding office as such before the appointed day, and shall, subject to the provisions of the articles of association of the Iron and Steel Company, hold his office and act in all respects as if he had been duly appointed under the said articles.

13 ***Dissolution of the Steel Corporation of Bengal, Limited.*** As from the appointed day—

(*a*) the Steel Corporation of Bengal, Limited, shall be dissolved and thereafter no person shall make, assert or take any claims,

demands or proceedings against the dissolved company or against a director or officer thereof in his capacity as such director or officer except in so far as may be necessary, for enforcing the provisions of this Ordinance,

(*b*) the right of every shareholder to or in respect of any share in the dissolved company shall be extinguished, and thereafter no such shareholder shall make, assert or take any claims or demands or proceedings in respect of any such share except as provided in this Ordinance

14 ***Power to make rules for facilitating amalgamation*** The Central Government may, by notification in the Official Gazette, make such incidental, consequential or supplementary provisions as in its opinion are necessary for fully and effectually carrying out the purposes of this Ordinance, and without prejudice to the generality of such power, provision may be made in such rules—

(*a*) for the allotting or appropriation by the Iron and Steel Company of any shares, debentures, policies or other like interests in that company which are to be allotted or appropriated under this Ordinance by that company to or from any person,

(*b*) for the disposal of shares in the dissolved company which do not represent one fully paid up share in the Iron and Steel Company under clause (*b*) of sub-section (1) of section 7, whether by the surrender to the Iron and Steel Company of the fractional certificates relating thereto with other fractional certificates so as to represent in all one fully paid-up share, or, at the option of the shareholder, by the surrender of the fractional certificates to the Iron and Steel Company for sale by the company on his account,

(*c*) for fixing the period within which any action required to be taken under this Ordinance may be taken,

(*d*) for the alternation, notwithstanding anything to the contrary contained in the Indian Companies Act, 1913 (VII of 1913), of the memorandum or articles of association of the Iron and Steel Company for the purpose of increasing the capital of the company or the borrowing powers of the directors thereof or for the purpose of securing the representation of the Central Government on the Board of Directors of the company or for any other purpose,

(*e*) for requiring any person concerned with the keeping of the register of the holders of any shares, securities or investments now transferred to and vesting in the Iron and Steel Company to forthwith register the name of the Iron and Steel Company therein, and to issue to the Iron and Steel Company the appropriate documents of title relating to the shares, securities or investments transferred to and vesting in it

RAJENDRA PRASAD,
President

K. V. K. SUNDARAM,
Secy. to the Govt. of India.

REPORT ON THE FAIR RATIO BETWEEN THE ORDINARY SHARES OF THE STEEL CORPORATION OF BENGAL LTD., AND THE INDIAN IRON & STEEL CO. LTD.

1. ***Origin of the case.*** In the two Reports submitted by the Tariff Board in 1949 and 1951 on the fair retention prices of steel produced by the Steel Corporation of Bengal Ltd. the Board had recommended the merger of the Steel Corporation of Bengal Ltd., and the Indian Iron and Steel Co. Ltd. The Tariff Commission in its Report in 1952 on the fair retention prices of steel produced by SCOB stated that the merger besides improving the economic position of both the plants will help the expansion of iron and steel capacity in the country and that it was in the national interest that the merger should take place. The Commission therefore, recommended that the companies should make a determined effort to bring about the amalgamation of the two plants as early as possible.

2. ***Reference to the Commission.*** In their letter No. SC (A) 2(89) 52 dated 15th October 1952 the Government of India in the Ministry of Commerce and Industry accepted the Commission's recommendation in regard to the merger of SCOB and IISCO and agreed that the merger should be brought about with the least possible delay. Government also stated that they had reason to believe that without direct Government intervention the merger might be considerably delayed and that, therefore, they proposed to intervene in a suitable manner and desired to be advised on the fair ratio between the ordinary shares of SCOB and IISCO. They requested the Tariff Commission to examine with due regard to all relevant factors what would be a fair ratio between the ordinary shares of SCOB and IISCO and to make their recommendations. It was also suggested that the examination be made confidentially and the recommendations submitted before 24th October, 1952.

3. ***Nature of inquiry.*** The question of fixing a fair ratio between the ordinary shares of SCOB and IISCO which has been referred to the Commission for examination and report is of a different character from that of claims of industries to protection or assistance or of prices usually referred by Government to the Commission. It was not therefore, possible for the Commission to adopt the established procedure of collecting data from the parties concerned and of holding discussions with them before formulating its conclusions and recommendations.

4. ***Method of examination.*** After a preliminary discussion of the various aspects of the question of fixation of a fair ratio between the ordinary shares of SCOB and IISCO, Mr. N. Krishanan, Cost Accounts Officer, was deputed to Calcutta to collect the necessary data. The material collected by him at Calcutta has been embodied in the note submitted by him to the Commission.

5. ***Capital structure of the companies.*** (a) *Paid-up Capital*—The paid up capital of the Indian Iron and Steel Co. Ltd. and the Steel Corporation of Bengal Ltd., as on 31st March, 1952 and 31st December, 1951 respectively was as under.

IISCO

150,000 5% cumulative preference shares of Rs. 100/- each	Rs 1,50,00,000
2,552,596 ordinary shares of Rs 10/ each	Rs 2,55,25,960
Total	Rs 4,05,25,960

SCOB

119,954 5% cumulative preference shares of Rs 100/- each	Rs 1,19,95,400
3 288,890 ordinary shares of Rs 10/- each	Rs 3,28,88,900
Total	Rs 4,48 84,300

The 5% cumulative preference shares of IISCO were issued late in 1950 The value of debentures for IISCO was Rs 1,58 53,667/ There were no outstanding debentures for SCOB on 31st December, 1951

(b) *Rights of the cumulative preference shareholders*—The rights and privileges of the cumulative preference shareholders of IISCO are as follows (i) *dividends*—5% tax free cumulative, (ii) *on winding up*—repayment of paid up capital plus arrears of preference dividends up to the date of winding up No further right in participation in the profits or assets of the company, and (iii) *voting rights*—no right to vote at general meetings except at a general meeting convened by notice at the date on which preference dividends are in arrears for six months or upon any proposal for the winding up of the company or any proposal to modify any of the special rights or privileges attached to cumulative preference shares The rights and privileges of cumulative preference shares of SCOB are (i) *dividends*—5% tax free cumulative, (ii) *winding up*—repayment of paid-up capital plus arrears of preference dividend up to the date of winding up No further right in participation in the profits or assets of the company, and (iii) *voting rights*—right to attend or vote at general meetings if and during such period as the fixed dividend on such shares shall be in arrears for one year

(c) *Ordinary shares and their distribution*—The ordinary shares of IISCO and SCOB are distributed as under

	Number of ordinary shares	
	IISCO	*SCOB*
Banks	3,09,303	2,46,140
Insurance and Investment Companies	3,06,583	12,20,930
Individuals	19,36,713	18,21,820
Total	25,52,596	32,88,890
Number of Shareholders	7,091	4,837

The number of ordinary shares held outside India is 3,31,844 in the case of IISCO and 1,80,594 for SCOB

(d) *Office and associate shareholders*—Out of 19,36,710 shares of IISCO shown above under the head of individuals, 58,889 shares are held as under

		Number of shares
(a)	Directors and their family members, staff and associates	31,448
(b)	Martin Burn Ltd	27,441
	Total	58 889

The position in regard to SCOB is as under

		Number of shares
(a)	Directors and their family members staff and associates	33,580
(b)	Martin Burn Ltd	1,00,032
(c)	Indian Iron & Steel Co Ltd	11,00,000
	Total	*12,35,612*

6 ***Approach to the problem*** Our examination of this question has entailed a review of the financial position and prospects of the two companies from several angles Much of the material used by us is contained in the Reports of the Tariff Board and the Tariff Commission on the prices of pig iron and steel and the confidential enclosures to those Reports Further data are given in the note of the Cost Accounts Officer referred to in paragraph 4 Consequently, it is unnecessary in this Report to discuss our findings on the several factors which might be taken into account in determining a ratio between the ordinary shares of the two companies We consider it sufficient for the purpose of this Report to discuss the relative values of the ordinary shares of the two companies from two main angles, namely, the earnings of the two companies and the market prices of the two shares We have also considered whether a comparison of the equity value of the ordinary shares of SCOB and IISCO can afford a reasonable basis for determining the relative value of these shares We are of the view that equity value is not a correct measure of the worth of a going concern which primarily depends on the earning capacity of the concern There is no question in this case of the winding up either of the two companies and selling its assets in the open market for what they might fetch The two companies are to be merged as going concerns and hence the profit earning capacity of each, which depends upon the prospects of its business as a whole, has a more decisive bearing on the relative value of its shares than, say, the estimated replacement value of the assets We, therefore, do not propose to take into account the equity value of the ordinary shares of the two companies for arriving at a fair ratio between their ordinary shares

7 ***Earnings of the two companies*** The gross profits of

IISCO for the past eleven years and of SCOB for the past ten years, together with the amounts available for the distribution of dividends to the ordinary shareholders are shown in Annexures I and II. The following table shows the net profits available for distribution of dividends to ordinary shareholders and the percentage dividend declared during the past ten years in the case of the two companies

Year	IISCO Net profit available for ordinary shareholders Rs. in lakhs	IISCO %-age dividend	Year	SCOB Net profit available for ordinary shareholders Rs in lakhs	SCOB %-age dividend
1942-43	50 17	20	1942-43	26 37	10
1943-44	41 98	17½	1943-44	24 41	8¾
1944-45	38 33	15	1944-45	26 94	8¾
1945-46	38 21	15	1945-46	27 08	8¾
1946-47	8 60	3¾	1946-47	15 69	5
1947-48	19 88	7½	1947-48	2 67	Nil
1948-49	25 98	10	1948-49	9 19	3¾
1949-50	25 62	10	1949-50	21 28	6¼
1950-51	25 44	10	1950-51	19 00	6¼
1951-52	25 49	10	1951-52	24 59	7½

The average rate of dividend during the above period was 6 50 per cent in the case of SCOB and 11 88 per cent in the case of IISCO. This indicates a ratio of 1 1 83 between the dividends received by the ordinary shareholders of SCOB and IISCO respectively. We do not think, however, that a ratio based on past performance would provide a correct index of either the present or the prospective earning capacity of the two companies. The profits earned by the two companies in the past were affected by variations in production, some of which were due to purely adventitious circumstances and by the varying incidence of control. Besides, the two companies are in different stages of development. We consider it reasonable, therefore, that an estimate of the relative earning capacity of the two companies should be based on their actual earnings in the last accounting period, 1951 in the case of SCOB and 1951-52 in the case of IISCO, with adjustments for such variations in those earnings as might be expected to occur in the foreseeable future in the absence of the merger. The gross profit earned by SCOB in 1951 was Rs 111 83 lakhs and this was the highest since 1945. The profit would have been about Rs 120 lakhs if the company had not been called upon to refund a sum of Rs 11 19 lakhs to Government in 1951 on account of transactions with the Equalization Fund from April 1946 to May 1949 and if it had not received the E.P.T. refund of Rs 2 47 lakhs. Allowing for depreciation, taxation, repairs and replacement and the dividend on preference shares, the net amount available for distribution to

ordinary shareholders may be estimated at about Rs 30 lakhs This amount spread over SCOB's ordinary share capital of Rs 328 9 lakhs would indicate a dividend of Rs 9 12 per cent In the case of IISCO, the gross profits earned in 1951-52 were Rs 144 95 lakhs which was the highest amount since 1941-42 and was due to the record production of pig iron amounting to 493 000 tons Production of pig iron, however, normally shows a decline in each successive year after the relining of blast furnaces Allowance has also to be made for a decrease in IISCO s profits due to the fact that IISCO will probably have to deliver larger quantities of hot metal to SCOB in future and its sales of pig iron to outside parties, which are more remunerative, will consequently decline The rate for hot metal fixed under the IISCO-SCOB agreement is much lower than the rate at which IISCO is able to sell its pig iron to outside parties After allowing for these two factors and after providing for depreciation, rehabilitation of the Kulti plant, other expenditure of similar nature, the estimated tax liability and the dividend on preference shares, the net amount available for distribution to IISCO's ordinary shareholders may be estimated at Rs 30 lakhs This spread over IISCO s ordinary share capital of Rs 255 26 lakhs would indicate a dividend of Rs 11 75 per cent It may be observed that the percentage dividends so worked out should not be taken as dividends which, in our view, the ordinary shareholders of the two companies would be entitled to, or could be expected to, receive in the absence of the merger The actual dividends would obviously depend on the financial position of the two companies and the policies of the Board of Directors at the time when the dividends are declared The above percentages are only intended to provide an indication of the prospective earning capacity of the two companies On the basis of the above estimates of the profits likely to be available for distribution to ordinary shareholders of IISCO and SCOB, the ratio between the ordinary shares of these two companies works out to 1 1 288 or roughly 4 5

8 *Market prices of shares* The market prices of ordinary shares reflect the current expectations regarding the financial position of the companies concerned Annexure III gives the highest and the lowest quotations for the ordinary shares of IISCO and SCOB on the Calcutta Stock Exchange in each year from 1942 to 1951 and in each month from January to September 1952 Over the period 1942-51, the average of the highest quotations was Rs 43 66 for IISCO and Rs 35 70 for SCOB, indicating a ratio of 1 1 2 For the same period, the average of the lowest quotations was Rs 29 97 for IISCO and Rs 22 64 for SCOB, indicating a ratio of 1 1 3 Since, however, the market quotations during this period were influenced by certain factors which no longer operate, we consider it more appropriate to take the quotations for the last nine months The average of the highest quotations during the latter period was 26 54 for IISCO and 20 53 for SCOB and the average of the lowest quotations was 23 56 for IISCO and 18 32 for SCOB The ratio between the average highest quotations for IISCO and SCOB works

out to 1·1·3 and the same is the case with the average lowest quotations of the two companies According to market valuation during the last nine months, therefore the ratio between the ordinary shares of IISCO and SCOB was 4 5 2

9 ***Recommendation*** On a careful consideration of what is set out in paragraphs 5 to 8 above, and having regard to all other relevant factors, we have come to the conclusion that a ratio of 4 5 would be a fair ratio between the ordinary shares of IISCO and SCOB and we, therefore, recommend it

sd/ D K. Malhotra,
Secretary,
23rd Oct., 1952

sd/- M D Bhatt,
Chairman

sd/- B V Narayanaswamy,
Member

sd/ B N Adarkar,
Member

sd/- B N Das Gupta,
Member

18

Corporate Reorganization and Reconstruction

Reorganization and reconstruction of companies relate to giving new life and vigour to companies in difficulties Like individuals *companies also have to face difficulties or pass through periods* of adversity The path to business success is not an easy one, and as such failures of business firms are not uncommon

Over a thousand new companies are registered every year in India and a little less than a thousand are liquidated There are certain years when there are more failures than formations[1] The continued annual entrance and exit of thousands of businesses keeps the *nation's economic structure in* a state *of dynamic flux* It leads to unemployment of a large number of workers, makes for technological inefficiency in labour and increases the uncertainty of a job for a large proportion of the labouring population Purchasers of durable goods find the service life of their purchase reduced because of reduced repairing facilities, resale values, if desired, are greatly reduced, liquidity is considerably lowered

Definition of failure—In its broad sense, failure is the opposite of success In the business world, however, the term is generally used for a certain degree of lack of success We may say that a business is not successful when it fails to earn a profit, but we do not use the term 'failure' until conditions become such that management cannot or will not pay debts when due or decides to close its doors When such conditions are encountered, the business is a

[1] From 1956-57 to 1961 62, more companies ceased work than those formed each year as shown below

Year	*Cos formed*	*Cos ceased work*
1956-57	848	1 135
1957 58	961	2 070
1958-59	1 095	1,993
1959-60	1,452	2,004
1960-61	1,683	2 482
1961 62	1,614	2 841

failure Since creditors may voluntarily waive claims when due, some persons wisely reserve the use of the term 'failure' to the time of official declaration of bankruptcy One should, however, bear in mind that a business may operate for a considerable period under conditions associated with failure it may incur a loss continuously and be on the verge of failure The sale of a business as a going concern, even at a substantial loss, does not constitute a business failure, unless there were bankruptcy proceedings involved

Financial difficulties of corporations—Just as there are many financial disabilities which an individual has to face, so also are those of the corporations From the accounting standpoint the financial ailments of corporations may be viewed as to the money value relations between assets and liabilities Four stages of failing conditions are recognized[1] (1) *Financial embarrassment* arises when the cash and revenues, including current borrowings, are just barely able to meet the company's disbursement aquirements It is a slight degree of illness which, if not remedied, will lead to the more serious disease of insolvency (2) *Financial insolvency* is but a step removed from financial embarrassment In this condition the corporation is unable to meet immediately maturing liabilities either because of their size or because of the sudden depletion of the cash fund and exhaustion of credit lines (3) *Total insolvency* the third degree of financial debility, means that there is an excess of total debts over total assets It may, and frequently does, happen that the company has sufficient funds to meet current requirements (4) *Confirmed insolvency* or *legally determined insolvency* is a condition in which court authority has determined that total insolvency actually exists

Causes of Failure

Failures have been attributed to many causes The causes may broadly be divided into three classes (1) External, (2) Internal, and (3) Technical

1 *External causes* are those which management cannot reasonably be expected to foresee, even a prudent man cannot be clairvoyant They include

(i) Excessive competition
(ii) Change in demand for the product of the company
(iii) Acts of God Earthquakes,
A tidal wave
A hurricene,
Fire,
Windstorm,
Flood,
Explosion, etc

[1] F I Burtchett and C M Hicks *Corporation Finance*, 1948, pp 618 19

(iv) *Government acts* New tax legislation,
Tariff revisions,
Legislation,
Price controls,
Labour controls,
Material controls,
Court decisions, etc

(v) Adverse acts of labour or other organizations

(vi) Business cycles (prosperity, decline, depression, recovery)

2 *Internal causes*—Causes of failure in this class are generally attributed to incompetent management Some of these, however, may be attributed to the incompetence of the original promoter or the entrepreneur Important ones are

Managerial incompetence (lack of judgment, consideration, tact or general ability)

(a) Excessive operating expenses,
(b) Inadequate revenues,
(c) Over-capitalization,
(d) Excessive floating debt,
(e) Inadequate maintenance of properties,
(f) Unwise dividend policy,
(g) Fraud,
(h) Personal extravagance,
(i) Speculation outside legitimate business

3 *Technical causes*—Although a business failure is a financial failure, non-financial causes can bring it about A business unit is first of all a producing unit Its financial record is the result of public regard for its wares and the efficiency with which it employs the factors of production If its product is defective, or its workers incompetent, or its departments disorganized, it can fail as surely as if its capital structure were top-heavy These technical causes of failure have to do with *operations*, with *industrial engineering*, and are technological rather than economic or financial in character

In a manufacturing concern, several important aspects of a company's operations lie within the province of the engineer, as they may also lie in transportation, communications, and the production and distribution of power Logically, it is the duty of the original promoter to survey the technical aspects of the projected enterprise, and subsequently it is up to management to make its decisions wisely and correctly. It is an old truism that a project can be an engineering success, but an economic failure , the reverse is also true A project may have every prospect of becoming an economic success, but the prospect will fade away if it is not also an engineering success Promoters are prone to minimize purely physical factors the plant site, type of building, the kind of floors, spacing of columns, stairways and elevators ; the roof, walls, partitions, doors and windows , heating, ventilation, and lighting ; and the kind of power

Mistakes in the form of obsolete machinery improper plant layout or defective product design cannot be left uncorrected for long in an age of rapidly developing technology

It is not easy to isolate with exactness the causes of failure in any individual case A series of contributing circumstances may be responsible for a single event of failure An American authority has divided the various causes of failure into two broad classes (1) fundamental and (2) apparent Their relative importance is shown in the following table[1]

Causes of Business Failures in the U S , 1955

Fundamental causes	%	*Apparent causes*	%
Inexperience and incompetence	91 3	Inadequate sales	46 7
		Competitive weakness	21 4
		Receivable difficulties	9 8
		Excessive fixed assets	9 1
		Inventory difficulties	8 3
		Heavy operating expenses	7 1
		Poor location	3 1
		Other	4 3
Neglect	4 8	Poor health	2 6
		Bad habits	1 2
		Marital difficulties	0 5
		Other	0 5
Fraud	2 1	Irregular disposal of assets	1 3
		False financial statement	0 4
		Premediated overbuy	0 1
		Misleading name	0 1
		Other	0 2
Disaster	1 4	Fire	0 7
		Burglary	0 1
		Flood	0 1
		Employees fraud	0 1
		Strike	0 1
		Other	0 3
Reason unknown	0 4	Because some failures are attributed to a combination of apparent causes the total of this column exceeds the total of the column on the left	
Total .	100		

Importance of human element in business failure—The above table indicates the importance of the humann element in business failure It also shows how failure is dependent primarily upon the degree of competence and experience of management Studies

[1] W H Husband and G C Dockeray *Modern Corporation Finance* 1957, p 635

conducted for an earlier period in the U S showed that over 40% of the failures was primarily attributed to incompetence and another 40% to the lack of management experience Although incompetent management is the most important single cause of business failure, there are other deteriorating influences shrinking markets, prolonged labour strikes, and various external events mentioned above

Methods of detecting failure tendencies Trends toward failure may be detected by an analysis of data coming from within the business itself, or from outside sources Technically, the former is called the *internal method*, and the latter the *external method* Outside sources include trade reports and statistics and economic indicators published by the Central or State Governments and by private organizations An analysis of the financial statements over a period of years has revealed the following failure tendencies

(1) Insufficient working capital
(2) Weak cash position
(3) Over-investment in receivables
(4) Over-investment in inventories
(5) Excessive or overvalued fixed assets
(6) Excessive bank loans and current liabilities
(7) Burdensome funded debt and fixed liabilities
(8) Over-capitalization

Additional failure tendencies are

(1) Declining sales
(2) Increasing costs and expenses such as labour, cost of goods sold, overhead, etc
(3) Excessive selling and administration expenses
(4) Burdensome interest or other fixed charges
(5) Excessive dividends or withdrawals
(6) Declining net profits and a lower rate of return on invested capital

This analysis of the causes of failure is by no means exhaustive, it simply furnishes a starting point, and a careful analyst will soon find other internal as well as external relationships of further significance

Results of Failure

Whatever the causes of weakness, when financial collapse is imminent, a choice must be made among these courses of action

1 Complete or nearly complete recovery
2 Dissolution On the part of most managements, this is the least desirable
3 Reconstruction and reorganization, i e, reconstruction of the corporate structure and the rehabilitation of its financial programme, and reorganization of the concern and the subsequent transfer of its assets to a new concern

Reorganization and Reconstruction in India

The Indian Companies Act 1956 makes, in sections 390-396, a provision for giving new life and vigour to companies in difficulties The provision is a source of strength to weaker companies which have been passing through adverse times and are almost on the verge of liquidation It is an alternate to winding up The law permits four different ways of overcoming the difficulties (1) Arrangement or compromise, (2) Reorganization, (3) Reconstruction, and (4) Amalgamation We have already discussed the procedure, *methods*, etc, of amalgamation in a previous chapter Here it is proposed to discuss the meaning, objects and procedure, etc, of the other three methods

1 *Arrangement or Compromise*

When companies overburdened with accumulated debts and liabilities wish to carry on their business profitably, they decide to relieve themselves of the burden due to creditors or debentureholders or even the shareholders This relieving of the burden or the settling of the dispute, if any is done through what is termed as an "Arrangement or Compromise *with the creditors or the members* A *compromise* is the settlement of a matter at issue between the company and its creditors or members or any class of members It is an easy *method of terminating* a *controversy* by *making* mutual concessions, as distinguished from adjudication on the basis of exact ascertainment of the opposing rights In a compromise, the parties agree *to try it out but to settle it* between themselves by *a give-and-take arrangement* It is essential for the purpose of compromise that each party thereto should be empowered to make the necessary concessions A company has the same right to compromise claims brought against it as individual persons have A reasonable compromise must be one which can, *by reasonable people conversant with the subject*, be regarded as beneficial to those who are making it

In addition to compromise, *an arrangement* includes a reorganization of the share capital of the company by consolidation of shares of different classes or by division of shares or by both the methods

A company, if it is not running its business profitably, may make arrangements or compromises with its debentureholders to forego their interests on debentures for a certain period or to accept a lower rate of interest on their debentures Debentures, which are redeemable, may be made irredeemable It can also request its creditors to accept shares or debentures in satisfaction of their debts The preference shares may be converted after consultation with their holders into equity shares or if they carry a higher rate of dividend, it may be lowered All such agreements with creditors or members are compromises or arrangements The old contracts are to be negatived or modified as soon as the compromise

or arrangement is made Thus, a new contract comes into force and replaces the old one which was not conducive to the welfare of the company

A company or its shareholders or any class of shareholders or its creditors or any class of creditors can make a move for such a compromise or arrangement under the provisions of the Companies Act. An application may be made to the High Court by any of the parties mentioned above The court may order meetings of creditors or class of creditors or members or class of members to be called, held and conducted in such manner as it directs The majority of three-fourths having agreed to the proposed compromise or arrangement and the court s sanction having been obtained, the scheme of compromise or arrangement becomes binding on the parties concerned

The chief advantages of a scheme or arrangement are that a majority of creditors may bind the minority, by accepting debentures *or shares in lieu of cash or foregoing arrears of interest*, *that* a majority of shareholders of a class may bind the minority without the necessity for purchasing the interests of dissentients, and that (*unless as part of the scheme a new company is formed to purchase* the undertaking) the expense of registration and the stamp duty on the transfer of assets is avoided.

In this country, particularly in West Bengal, on account of economic distress, a large number of loan companies which took deposits of money on condition to repay at a notice of a week, six months, a year, or at most two or three years, and having no corresponding liquid assets, has been unable to meet the demands of the depositors They have largely taken advantage of this provision of law Most of them having adequate securities in landed properties, hope to repay the depositors' money if they can get sufficient time For this purpose a scheme is prepared for sanction at a depositors' and creditors' meeting under which they agree not to demand their dues (whether under judgment or not) for a certain number of years in which time the company undertakes to pay them gradually and rateably as the company's dues from its debtors are realized. As regards management, in the meantime, majority of the directors are elected, under the scheme, by the depositors and creditors and the directors again select the managing *directors and other executive authorities of the company and* control them in the matter of realization and distribution of the money realized The depositors and other creditors readily assent to the scheme as they have found by experience that they may get more in this way than by a compulsory liquidation, which is troublesome and expensive

In this way, within the time allowed in the scheme, the assets of the company must be realized and distributed, but on the expiration of the time, or on the failure of the company to pay instalments provided in the scheme, the creditors will be at liberty to take whatever action they choose

In England, the commonest form of the scheme of arrangement and compromise is that a company is to be formed, that the debentureholders of the existing company shall take in exchange debentures or preference shares of the new company and the unsecured creditors shall take a composition of so much in the pound payable partly in cash and partly in shares or debentures in the new company and that shareholders receive only partly paid-up shares in the new company

2 ***Reorganization***

Reorganization is the first practical alternative to give a company a fair chance to solve its financial embarrassments and avoid the penalty of liquidation It is the process of tearing down the old structure and using the materials in a new and stronger structure It is not merely a series of compromises and forced sacrifices imposed upon shareholders and debentureholders, it is rearrangement of the company s liabilities If worked out on ideal lines, a reorganization may be described as a new financial plan which replaces the old plan which has proved faulty

Objects—Sometimes companies, even though they may be earning profits, are not in a capacity to pay dividends on their share capital or to meet their obligations and liabilities without some alteration of their capital structure In case the company is over-capitalized and it has incurred heavy debts on which interest is due, it cannot survive save in running loss So to avoid liquidation and in order to stave off creditors by continuing to pay their interest, the company has to deplete its cash resources and make an arrangement either with its shareholders to alter or revise their rights and privileges or with its creditors and debentureholders in respect of their loans or privileges attached thereto Thus reorganization is brought about in respect of company s owned (internal) or borrowed (external) capital This is done to achieve the following objects

(i) To simplify the capital structure with a view to raising further capital,

(ii) To reduce fixed charges,

(iii) To eliminate past losses,

(iv) To take care of accumulated preference dividends,

(v) To pay or provide or create fund for pressing obligations,

(vi) To safeguard future benefits by sacrificing temporarily for the common good In the scheme of reorganization some of the classes of shareholders and creditors make some sacrifice for the common good but the stream of ensuing profits is thus kept flowing by removing the obstruction—a cause of continuous loss

A company may embark upon the schemes of reorganization independently or such schemes may be part of the plan of reconstruction or amalgamation of companies Reorganization does not lead to winding up of the company It continues its separate exis-

tence with necessary rearrangement of its capital structure involving some sacrifice and variation in the rights of members or creditors

3 ***Reconstruction***

The term 'Reconstruction is not of any legal significance, but is widely used in corporation finance It means the formation of a new company to take over the assets of the old one with the idea that substantially the same business shall be carried on by the same persons It is not essential that a new company should be formed to take over the old one, but even an existing company carrying on the same type of business may come to its rescue The company which has almost exhausted all its financial resources may be wound up or dissolved by an order of the court Generally companies which are not successful in carrying on their business in their infancy or at the outset and incur heavy losses resort to the scheme of reconstruction keeping in view a bright future for their business and in order to preserve their existence in an altered form, and arrange with either other similar existing companies or get floated other companies to take over their business The directors and the members of such an old company who are really interested in its future development *become the members of the new company which has its own new* constitution (Memorandum and Articles) and form Sometimes the members of the old company have to accept partly paid shares in the new company in exchange for their fully paid shares in the old one Thus, the new company is able to make up the loss of the old one and raise fresh additional share capital The new company takes over all the assets and liabilities of the old company It can also have the same or similar name

Objects—The chief objects of a reorganization scheme are

(i) Carrying on business more profitably by widening the range of its activities and making a necessary change in the Memorandum of Association.

(ii) *Acquiring additional working capital to run the business* by issuing partly paid-up shares in exchange for fully paid up shares and calling the balance in future

(iii) Avoiding evils of over-capitalization or writing off the lost capital.

(iv) Changing the place of business of the company

(v) Reorganizing or rearranging the capital.

(vi) Making a change in the rights of shareholders

(vii) Effecting a scheme of compromise with creditors and to convert their claims into shares or debentures of the company being formed

Modes of Reconstruction There are two methods applicable to reconstruction schemes

(i) By sale under the Memorandum, followed by winding up

(ii) By sale and transfer of assets

(i) *By sale followed by winding up*—Where a company wishes to extend its activities, involving a change in the objects clause of its Memorandum not permissible by law, a new company could be formed having the desired objects The old company could transfer or sell its undertaking to the new company, the shares in the new company being issued to existing members of the old company Thereafter the old company resolves to go into voluntary liquidation

(ii) *By sale and transfer of assets*—The law empowers a company which is being wound up altogether voluntarily (called transferor company) for the purpose of transferring the whole or any part of its undertaking to another company (called transferee company) to appoint a liquidator The liquidator of the transferor company may, with the sanction of a special resolution of that company, receive compensation for transfer or sale, shares, policies, or other like interests, or in addition thereto participate in the profits of or receive any other benefit from the transferee company Any sale or arrangement made by the liquidator shall be binding on the members of the transferee company

Procedure of Reorganization and Reconstruction

Whether it is an arrangement or compromise, or reorganization or reconstruction, the Indian Companies Act, 1956 lays down a common procedure to be followed The proposal for a compromise, reorganization or reconstruction may come from the company itself, its members or any class of members, its creditors or any class of creditors, or the liquidator if the company is already under liquidation The person making a move has to apply to the High Court The High Court has the power to order meetings to be called, held and conducted in such manner as the court directs An order having been received from the court, the meeting of the section of the group making the move is held and a scheme of compromise, reorganization or reconstruction is prepared If the majority of three-fourths of the class of persons agree to the scheme the court has the power to sanction the scheme on its merits The court has also power to supervise the whole of the proceedings of the meetings and other matters incidental to the implementation of the scheme

A scheme is not effective unless it is sanctioned by the court which in its turn cannot sanction the scheme until it has been accepted and approved by the three-fourth majority The law allows the decision of the majority to bind the minority Therefore, it is incumbent on the court to see that the *decision does not act oppressively on the minority* and that *it is a reasonable and practicable scheme.* The court has to look at the arrangement and see that *it is such that a man of business would reasonably approve* and further that *it is fair and reasonable as regards the interests of all concerned* The court has also to consider whether the scheme *will be conducive to public interest and commercial morality* It is very essential that the scheme

must, as far as possible, be based upon correct information The court has the power to call for a report to give a fair idea of the *affairs of the company at the moment for the purpose*

The court will reject a scheme if it is satisfied that material facts were not placed before the meeting, whether intentionally or *otherwise, or that the object of the scheme is to prevent an enquiry* into matters that require investigation or that the scheme is not a practicable and feasible one Nor should the court sanction a scheme *which proceeds upon the assumption of honesty and efficiency* of the management not justified by their past conduct particularly in not complying with the provisions of law The court should always *prefer a living scheme to a compulsory liquidation* bringing about the end of a company and usually without any hope of payment in full It is the business of the court to satisfy itself that (1) the meeting was duly held and conducted (2) the compromise was a real one, (3) it was accepted by a competent majority, (4) the majority was acting in good faith and for common advantage of the whole class, and (5) what they did was reasonably prudent and proper

Dissenting shareholders—Where a scheme or contract involves the transfer of shares of one company to the other, the provision has to be made for satisfying the dissenting shareholders, i.e., shareholders who have not assented to the scheme or contract or those who have refused to transfer their shares to the transferee company in accordance with the scheme or contract In such cases, the court, while making the order, has to consider whether the dissenting shareholders are to be left in possession of their shares or they should be compelled to sell their shares, on the same terms as *accepted by other shareholders Before sanctioning the scheme, the* court can impose conditions upon the company for making provisions for dissenting shareholders The court, however, does not necessarily make such a provision for dissentients, if it is satisfied that the scheme *is reasonable and fair and in the interests of the general body of shareholders*

To make the discussion more clear and specific, a few examples of actual decisions of the courts in India and England are given below both where the court sanctioned the scheme and where it did not

Schemes court may sanction

The schemes which have from time to time been sanctioned by the Court under this section are of the most varied descriptions *Thus*—

(1) Debentureholders and creditors have accepted shares for their debts ,

(2) Existing debentureholders have agreed to take up new debentures to be created ,

(3) Creditors have received part cash and part debentures or part cash and part shares in satisfaction of their debts ,

(4) One creditor has taken over all the assets, and paid the costs of the winding up and a composition to the other creditors ,

(5) Shares or debentures have been accepted in lieu of arrears of debenture ,

(6) Debenture interest has been reduced to enable future profits to be devoted to the redemption of the debentures

(7) The scheme may, and often does, involve formation of a new company to acquire all or part of the assets or if a liquidation is in progress, it may provide for a stay of the liquidation and the continuance of the old business

(8) It may also involve the reduction unification, consolidation or reorganization of the capital of the company, or the modification of the rights of a class of shareholders

(9) *Specific cases*

(a) *Dawson* vs *Hormusji, 1932*—The Dawson s Bank had a laudable object, the advance of capital to cultivators Its capital consisted mainly of fixed deposits Its success depended upon the proceeds of paddy crop year by year On account of the general economic depression on the one hand and the Burma Rebellion on the other, the bank became temporarily embarrassed though financially sound The bank realized that on the date of the maturity of the deposits they would not be able to meet the demand unless the depositors could wait Under these circumstances the creditors at a meeting approved (practically unanimously) a scheme the substance of which was that in lieu of liquid capital in the form of deposits, the depositors were given the option of taking either debentures or preference shares, thus enabling the company to obtain fixed and more or less permanent capital with which to carry on the business The alternative to this scheme was the winding up of the company The court held that the scheme was eminently reasonable and ought to be sanctioned

(b) *Edinburgh Rly and Property* vs *Scottish Assurance Co , 1917*—In Scotland a scheme was sanctioned which involved the alteration in the Memorandum of Association in order to clarify the rights of the several classes of shareholders, those rights not being clearly stated in the memorandum

(c) *Tata Iron and Steel Co , 1928*—The point as to whether directors can make a proposal for a scheme under section 153 without the sanction of a general meeting was mooted in this case It was held that they could even if a scheme involves incidentally the alteration of the memorandum or articles , there is nothing in the articles or in the law to require that a bare proposal to alter the memorandum or articles shall be made by the company in general meeting The court can sanction a scheme even involving alteration of memorandum without a resolution passed at a general meeting under *section 153* , it was quite unnecessary to

consider at that stage the question of any alteration of the memorandum

(d) *Coming & Jarret Timber Co, 1900*—A scheme of arrangement for reconstructing a company was proposed involving the formation of a new company and substitution for the existing debt liabilities different debt liabilities of a new company It was observed with regard to the scheme

If the liquidator is willing to undertake to pay unsecured creditors in full and not to act upon underwriting agreements we will hear the respondent with the modifications which have been discussed and which are now assented to by the liquidator I think we may sanction the proposed scheme

(e) *Shandon Hydropathic Co 1911*—Schemes involving conversion of terminable debenture bonds into perpetual debenture stock can be sanctioned

(f) *Sandwell Park Colliery Co, 1914*—If proper provision is made for dissentient members reconstruction of an existing company by winding up and sale of the entire assets for shares in a new company can be effected under Section 153

(g) *Kamalapat vs Union Indian Sugar Mills, 1929*—Where a scheme is amended after approval by court the members must meet again to consider the amended scheme and the court can approve of modified scheme

(h) *Tea Corporation, 1914*—Where some of the classes have no interest because the assets will be exhausted by those who have priority over them their assent is not necessary

(10) The Court may sanction schemes containing the following provisions

(a) That shares in the company shall be sub-divided and that each shareholder shall surrender some of the shares resulting from the sub division to another company whose undertaking is to be merged in that of the company whose shares they hold,

(b) That the first mortgage debentureholders are to be satisfied by other debentures or charges about to be issued or created,

(c) That in place of debentures guaranteed by a third party, debentures without a guarantee are to be issued to the holders and the guarantor released,

(d) That debentureholders and other creditors are to accept in satisfaction of their debts shares in a company to be formed,

(e) That debentures the interest on which is to be payable out of the profits of the company, are to be taken in satisfaction of debentures the interest on which is payable whether profits are made or not,

(f) That debentures repayable at periods of from three to five years shall be converted into debenture stock repayable only in a certain limited number of years

Cases where court will not give sanction

(a) *Albert Life Assurance Co, 1871*—A court will not sanction a scheme when it is impossible to estimate the amount of the debts

(b) *Oceanic Steam Navigation Co, 1939*—The court cannot sanction a scheme which involves the doing of an act which is *ultra vires* the Co

(c) *General Motor Cab Co, 1913*—A scheme for sale of company's undertaking to a new company without provisions for dealing with dissentient shareholders was not approved of by court

(d) *Richards and Co, 1879*—A scheme cannot be sanctioned so as to prejudice the rights of a creditor who would be entitled to preferential payment in the event of a winding up

(e) *Nilphamari Luxmi Bank, 1936*—A scheme will not be sanctioned to enable an insolvent bank to continue its business

(f) *St James' Court Estate Ltd, 1943*—The court will not sanction a scheme of arrangement whereby the company proposes to convert issued preference shares into redeemable preference shares

Reorganization in the United States

The American Law provides for '*reorganization*', '*adjustment*' and '*arrangements*' The term *arrangements* refers to the "settlement, satisfaction, or expansion" of unsecured debts It provides for parity treatment of all unsecured creditors or for equitable priorities Its purpose is to facilitate reorganization involving only the adjustment of unsecured debt It deals with less serious cases of insolvency It is a substitute for the composition arrangement of the Bankruptcy Act of 1898 If the difficulties are relatively minor and the company has a sound economic justification, a co-operative *arrangement* may be worked out with its creditors The legal provision of arrangements was sponsored by the National Association of Credit Men and other groups of creditors' representatives expert in bankruptcy It is built around the principle of relief for the creditor All creditors must join in any plan, however, and a voluntary agreement of this sort is most likely to succeed if they are few in number and the business is small Then the interest of all creditors will be similar in working out an arrangement that will avoid legal complications and the costs of foreclosure Since the creditors will consist primarily of suppliers of materials and the local bank, they have a joint financial interest in the survival and welfare of the debtor Sometimes the principal creditors will even advance additional funds to pay off a group of

the small debts Such an arrangement presumes a harmony of interest among those having a financial stake in the corporation and is dependent upon the expectation by all that they will recover the face amounts of their credit extensions As soon as this expectation is lost, the differing relative positions of the creditors will complicate any agreement The very framework of failure is not conducive to harmony

Adjustment implies changes which merely modify accounting, that is, financial set-up, and bring it more nearly into line with new or newly recognized conditions It is also termed as *financial adjustments* or *readjustments or corporate recapitalizations*

Reorganization is a rather drastic reshaping of the affairs of the corporation involving either receivership or bankruptcy proceedings, and generally with the formation of a new corporation to take the place of the old one Most of the authorities in the United States prefer to use the term 'reorganization' and regard *reconstruction and reorganization, in effect, as one and the same thing* In practice also, reorganization includes reconstruction, though reconstruction does not necessarily involve reorganization *Reconstruction* is a reshaping of the affairs of the corporation, arising from the demands of the securityholders, without receivership

In the U S A , reorganization is the most complex phase of corporation finance , it is the intricate phase of the whole subject , *it is also one in which generalizations, principles, and precedents* are of the most doubtful application It is, therefore, proposed to discuss it in sufficient details

Objects of Reorganization

Reorganization is needed when a company has not been able to pay its obligations or to defer them by some voluntary method of compromise with creditors The procedure attempts to transform a business failure into a success. It is assumed that a corporation will be worth more as a going concern than if it were liquidated These are economic problems At the same time, if salvation is to be assured, the corporation's contractual obligations must be satisfied or adjusted. These are legal problems What it must do legally and what it can do financially are matters of negotiation, compromise and simple justice A major problem of *such corporations is their low income level or outright losses* One purpose of reorganization is to increase the economy of operation and the efficiency of the organization in order to increase the volume of business and decrease costs

Objects of reorganization depend upon the type of enterprise and the causes of difficulties They are different for different concerns *In general, the chief objects of reorganization are*

1 Reduction of floating debt
2. Reduction of fixed charges
3 Acquisition of new working capital

4 Disposal of unprofitable properties
5 Release from unprofitable contracts especially burdensome leases
6 Satisfaction of creditors
7 New management if deemed necessary or desirable

Methods of Reorganization

The methods of reorganization are even more unprecise than the objectives Nevertheless following the above outline of objectives the methods may roughly be stated as follows

1 *Reduction of floating debt*—Creditors may be willing to sacrifice part of what is due to them in order to be sure of some of it, or in order to avoid litigation or for both reasons On the other hand, it may be necessary to raise funds from securityholders The common shareholders are the most likely source

2 *Reduction of fixed charges*—The bondholders may be asked to accept a reduction in the face amount of their holdings or in the rate of interest thereon Only those whose claims are affected can be expected to do so They may be offered income bonds or preferred stock, or they may agree to a postponement of maturities

3 *New funds for working capital*—These are usually obtained from the following sources

(a) Assessments on the common stockholders and other affected securityholders if any

(b) Sale of new securities to outsiders

(c) Sale of unnecessary assets

4 *Disposal of unprofitable properties*—It is related to the sale of unnecessary assets Such properties may be in the form of little used warehouses, old machinery, unnecessary subsidiary companies, etc

5 *Release from unprofitable contracts* may be obtained through negotiation The owners of a property which is leased to the corporation may see fit to accept a lower rental rather than to force the corporation to relinquish it through dissolution and, therefore, throw it back upon lessor s hands

6 *Satisfaction of creditors*—All creditors must be satisfied' before the enterprise whether in old or new form, can proceed Some creditors may be willing to accept partly cash and partly securities

7 *New management*—New management may be elected simply by the voting stockholders casting their votes in accordance with their own wishes Frequently creditors may have some voice in the choice of management if they are to go along with the security holders

Procedure of Reorganization

The Chandler Act 1938 lays down the procedure of reorganization of distressed units or companies in many fields of activity It provides for two types of reorganizations of industrial and

public utility companies: (1) The larger corporate enterprises that have securities in the hands of the public are usually reorganized under Chapter X (2) Small firms with unsecured bank and merchandise creditors find it simpler to effect an arrangement under Chapter XI (already discussed above) The provisions contained in Chapter X limit the activities and powers of inside interests and protect the rights of independent investors

Steps in industrial reorganization The Bankruptcy Act prescribes certain steps in the orderly procedure of reorganization In chronological order they are

1. Filing a petition in Federal Court
2. Appointment of a disinterested trustee by the court if it entertains jurisdiction
3. Preparation of a plan of reorganization by the trustee
4. Hearings on the plan before the court
5. Advisory report on the plan prepared by the Securities and Exchange Commission
6. Court approval of the plan
7. Voting on the plan by the creditors and stockholders affected
8. Confirmation of the plan by the court and execution of the plan by the trustee

Acts of bankruptcy—According to the Chandler Act the acts of bankruptcy consist of (1) concealing or transferring property with intent to defraud creditors, (2) discriminating in favour of one class or group of creditors by allowing them to gain control of strategic property or making a general settlement with them while insolvent, (3) admitting inability to pay debts or a condition of insolvency A petition in bankruptcy may be filed against any person (including corporations) within four months of any of the acts mentioned above

Filing of petition—Reorganization proceedings are initiated in the jurisdiction of the debtors's principal office—not necessarily its corporate office The proceedings apply to all of the corporation's assets, wherever located, thus eliminating the need for ancillary actions Any corporation, industrial or public utility, other than a railroad, municipal corporation, bank, or building and loan association, may initiate a voluntary proceeding[1] An involuntary proceeding may be instituted by three or more creditors who have claims against the corporation or its property which amount in the aggregate to $ 500 or more A trustee under a mortgage, deed of trust, or indenture under which there are securities outstanding may also file an involuntary petition without the co-operation of any of the corporation's creditors, if the securities outstanding are 'liquidated' as to amount The trustee may also bring a suit on any violation of

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1 When filed by the debtor it is a voluntary petition; when filed by creditors or an indenture trustee it is considered to be an involuntary petition.

the deed of trust or indenture No one may file a petition if one has already been filed by or against the corporation The petition states that the corporation is insolvent or unable to pay its maturing debts A petitioning corporation must show its need for relief and suggest plans for reorganization and adjustment

Any interested party may file an answer to the petition or take exception to the statements therein The judge, if satisfied, approves the petition and dismisses it if not satisfied

Appointment of the Trustee—Assuming the approval of the petition, the judge is then required to appoint a disinterested trustee, or trustees, whenever the indebtedness of the debtor is \$ 250,000 or greater When the claims are less than this amount, the appointment is a matter of option with the court , and either an outsider or the debtor himself may be named In either case, the trustee becomes the agent of the court and is responsible accordingly This means the court may direct the trustee to investigate and examine the pertinent facts with reference to the condition of the debtor The trustee is disinterested in the sense that he has no direct or indirect connection with the corporation and is not connected with investment bankers, lawyers or others who have been concerned with the issuance of the company's securities The trustee is responsible for both analysing the financial problems and managing the firm Usually an officer or other employee of the company, who is acquainted with the technical details, will be appointed as an additional trustee whose activities are restricted to business operations

Preparation of the plan of Reorganization—The trustee assumes the responsibility for reorganization and enjoys the sole authority to formulate present and file the initial reorganization plan All interested parties are invited to submit plans , but these plans are brought to a head in the trustee, who, in turn, submits the final result to the court The trustee collects extensive factual data and the views of the creditors and stockholders can be presented

Hearing by the court—After the trustee has formulated a plan and has submitted to the court, the court sets a time for a hearing on the plan and on any objections, amendments, or substitute plans which may be proposed by the debtor or by any creditor or stockholder

Advisory Report of the Securities and Exchange Commission—The Securities and Exchange Commission occupies an important '*watch dog*' *position* in reorganization If the liabilities exceed \$ 300,000 the court is required to submit the plan or plans to that agency for an advisory report, and must postpone the approval of any plan until the Commission has either submitted a report or has indicated that it does not wish to do so This report accompanies the plan, and the court's opinion thereon, that is submitted to the securityholders for approval The Commission has acted as a technical expert for the court and an information centre for the investors

Court's approval of the plan—After the receipt of the advice

of the Securities and Exchange Commission, the court may announce its approval of the plan if it is satisfied on all points. Among the fourteen points detailed by the Act in this respect, important ones are: (1) provision for the payment of the costs of administration: (2) provision for any class of creditors which does not accept the plan by a two-thirds majority: (3) similar accommodation of any class of stockholders which does not accept the plan by a majority; (4) prohibition of the issuance of non-voting stock and provision for equitable distribution of voting power: (5) requirement that the terms, position, rights and privileges of the several classes of securities' are 'fair and equitable and in accordance with sound business and accounting practice.'

Acceptance and confirmation of the plan—After the initial approval by the judge, the plan is submitted to the creditors and stockholders, accompanied by the report of the Commission and the opinion of the court. Acceptance by interested parties requires approval by two-thirds of the amount of claims of creditors, and if the debtor is not insolvent, approval by a majority of the stock. If the debtor is insolvent, the consent of the stockholders is not required to make the plan effective.

If the creditors who hold two-thirds of the amount of the claims against the corporation and the holders of a majority of the stock of the corporation accept the plan, the minority creditors and stockholders are bound by the plan.

Following the acceptance, the judge is required to hold a hearing to consider any objections which may be made against the final confirmation. Ultimately, the court renders a confirmation, if satisfied that "the plan is fair and equitable and feasible" and that it has been made in good faith in keeping with the provisions of the act. With this conclusion, the plan becomes binding upon all parties concerned; and final decree is entered "discharging the debtor from all its debts and liabilities, closing the estate," and making miscellaneous clearances.

Objectives during Reorganization

Maintaining the going concern—Corporate reorganization is directed at the same purpose as individual bankruptcy. It accepts the assumption that the economy is benefited if the enterprise continues as a going concern, that the economy stands to lose if the bankrupt's property is seized and sold piecemeal. The thought that an industry should be fully manned is evidenced in the policy toward railroads and public utilities. They are required by law to maintain themselves as going concerns during reorganization. Their services are essential. In the Chandler Act industrial and commercial enterprises are also required to maintain themselves as going concerns. It is economically unthinkable that the Ford Motor Company, General Motors Corporation, or the United States Steel Corporation would be allowed to liquidate and disappear from the industrial scene. They and their kind would be reorganized.

Negotiation and compromise—The regulatory bodies and the courts are charged with the duty of conserving productive capacity To that end, they will try (while there is hope) to treat the company's recovery as just as important as the adjudication of contracts The owners of the Corporation and its officers may be motivated by the prospects of future profits, foreseen or imagined and that they are willing to try, try again At the same time, it would be useless to formulate a plan under which the patient will suffer a relapse The new capital structure must be supported by earnings Those who supplied equity and debt capital were both regarded as investors in the old company and entitled to participate in the new

Meeting current obligation—While the plan of reorganization is in preparation, the trustee, in addition to preserving the going concern, must also meet certain pressing obligations Even a bankrupt must have cash to operate An enterprise that expects to make a fresh start cannot ignore its current creditors, nor can it entirely neglect all previously incurred obligations Taxes must be paid, insurance must be maintained, pay-rolls must be met the channels of material supply must be kept open, orders must be executed if customers are not to be lost Therefore, the trustee will ask the management to co-operate with him in the preparation of a budget of the company's working capital requirements and operating expenses He will obtain a schedule of its important sales and purchase contracts Goodwill must be preserved, even at the cost of additional financial outlays Lines of bank credit for current needs must be kept open, or reopened

Obtaining cash during reorganization—The company is in reorganization because of lack of funds and an impairment of working capital In order to keep its operations, new funds are needed This is done by (1) assessments on the common stockholders and other affected securityholders, if any, (2) sale of new securities to outsiders, and (3) sale of unnecessary assets The stockholders usually receive new securities for their assessments which may be termed a 'subscription' The trustee may seek authority from the court to issue receivership certificates, more properly termed 'trustee's certificates' The trustee may raise cash through the sale of property or assets

Accomplishments of Reorganization—The reorganization plan, as finally completed, confirmed and put into effect, should achieve the following (1) the new company should be adequately provided with cash for its essential purposes, (2) the capital structure should conform with sound financial principles, (3) the difficulties responsible for the company's failure should have been corrected or eliminated, (4) the debt should be so reduced that earnings in the foreseeable future will be adequate for its servicing, (5) the capital structure should be simplified, (6) securityholders who dissented should be satisfied, equitably and beyond any possibility of reopening their cases

Reducing the capital structure—To save the company, some of

the original claims are invariably sacrificed. Subject to the bargaining power of various interests sacrifices may be expected from the following parties in order of their vulnerability (1) common stockholders, (2) preferred stockholders (3) general creditors having no preferential claims, (4) unsecured creditors with preferential claims, (5) junior-lien bondholders (6) senior lien bondholders (7) holders of receiver s certificates, (8) holders of securities not in default, (9) creditors possessing valid claims for reconstruction expenses (i e , wage earners (10) the tax collector

Reorganization presents the reorganizers with a golden opportunity to consolidate diverse security issues and simplify the capital structure, to 'clean up the balance sheet The capital structure of many companies is a patchwork of small issues some offered in times of stress, some during periods of growth , all were drawn to conform with market conditions that no longer exist These heterogeneous and inflexible capital structures can now be revamped in the interest of financial economy Debentures, junior bonds, and underlying issues can be consolidated into a single new issue A simple capital structure of a single issue of debt securities and one class of common stock will make financial administration easier and clear the way for additional financing in the years ahead.

Reducing causes of failure—The act has created the "disinterested trustee" who manages the corporate estate during reorganization Being in a dominant position, the trustee is in a position to review the record of management without prejudice If he feels that the officers should be displaced, the plan will so provide. This may be an important step towards eventual rehabilitation, because in most cases the failures are the result of bad management. The management may have been torn between its private interests and those of the corporation, or between the interests of the minority and those of the majority New blood and new nerve may save the firm.

Other accomplishments—Rehabilitation also presents an enterprise with the opportunity to divorce unprofitable affiliations and adopt new techniques New assets acquired during reconstruction may even elevate an outmoded business to a position equal or superior to that of its rivals The new capital structure may be planned to avoid some of the burdens of taxation. Reorganizations are sometimes launched for the purpose of merging profitable or divorcing non profitable subsidiaries and branches.

Equitable plans of Reorganization—The law provides that the plan must be "*feasible*", likely to work, give reasonable prospect of success If, in a particular case, the disinterested trustee is uninterested, and the corporation under his guidance becomes less of a going concern than it was before, any plan of reorganization is unlikely to be feasible To meet the test of feasibility the company must emerge from reorganization with a sound capitalization and with adequate working capital One must see whether a plan of reorganization will permit a self-supporting operation. The plan must be sound and not lead to another reorganization.

Secondly, the plan must also be *fair and equitable* No class of securityholders should be included in the reorganization unless there was an equity for that class Participation of claims and interests must be in the order of their priorities The planners must put first things first, and the first thing to do in reorganization is to evaluate the debtor's assets It is the value of the property that determines the extent to which each class can participate in the plan of reorganization The plan is unfair and inequitable if it diverts *assets values to a junior issue that should have been allocated to a* senior issue Creditors must be covered before stockholders participate, and if debts exceed the value of the property, all assets must be assigned to the creditors If the stockholders are to share in the plan they must contribute fresh capital The same applies between classes of stockholders In essence fairness is measured by the treatment of the rights and priorities of the old securityholders, and participation by junior interests is dependent upon the existence of an equity or a new contribution on their part These two phrases *are tantamount to saying that a business that fails should avoid failing in the future* It is important to note that the words 'fair', 'reasonable' and 'practicable' used for qualifying a good plan of reorganization in India and England bear a close resemblance and meaning to the words 'fair', 'equitable' and 'feasible' used in the United States of America for qualifying a similar reorganization plan

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always justify long-term borrowing and the real basis of long-term borrowing is provided by the stability of earnings

External factors

Economic environment—the business cycle The increase or decrease in the numbers and health of the living organisms is very much influenced by the changes in physical environment Similarly the prosperity or adversity of business units is affected to a very great extent by the changes in the economic environment Usually the term business cycle is applied to these changes taking place in the economic environment Sometimes the business activity is brisk, output increases margins of profit increase and the demand for investible funds also goes up This phase of the business cycle is usually called boom The time is favourable for new promotions To the contrary at other times the business activity is dull, production declines, margin of profit shrinks, there is paucity of investible funds and numerous weak business units go into liquidation. This phase of the business cycle is usually called 'depression' Between the periods of depression' and 'boom' there may be an intervening period of 'recovery' and between the 'boom' and 'depression' there may be a period of 'recession'

Prices of shares, in general, move up along with the expanding business activity during the periods of 'recovery' and 'boom' and move down as the business activity shrinks during the periods of 'recession' and 'depression' Long-term financing with ownership securities during the period of the upswing of the business cycle is advantageous At such periods the business confidence is high and equity shares are sold at a premium , it is also easy to sell preference shares almost on the same terms as are to be offered for debt securities The high prices at which shares can be sold are so tempting sometimes that there is a real danger of over-financing through equity shares although the funds may not be needed immediately Interest rates generally tend to go up during the period of brisk business activity on account of the increased demand for funds and the willingness of the borrowers to pay more for these funds It is probable that the prices of debt securities might show a downward tendency under these conditions The tendency of the interest rates to be higher during the period of brisk business activity than during the periods of dull business activity render the process of obtaining loan capital more economical and advantageous during the periods of comparatively lower business activity or the downward movement of the business cycle

Life cycle of an industry. Besides the general economic environment, the business units also have their own immediate environment provided by the particular industry to which they belong and just like business units the particular industries as a whole also pass through the different periods of their life cycle Scientific progress gives rise to new industries like plastics or artificial fibres, which begin the period of their childhood, some others like automobiles stand fully grown or

matured and still others like cotton textiles pass through their old age In India the industries like automobile manufacture or machine making are in their childhood, industries like sugar or cement have attained maturity and cotton and jute textiles have entered the period of their old age, some industries like indigo manufacture or salt petre died and disappeared long ago

The problems of units operating in industries passing through the different stages of their life cycle are also different In new industries the number of firms in the beginning is smaller, the techniques and methods are not fully developed, the destinies of some of them are guided by dynamic personalities For expansion the saved earnings are usually the main source of long-term finance As the industries reach the stage of maturity, the techniques and methods become established and well-known, the intra-plant and inter-plant specialization proceeds further with speed, the size of units increases through the process of horizontal and vertical combination, and the management usually gets impersonalized During this stage the securities of the units are listed on the stock exchanges of the country and the needs of the long-term finance are met through the mechanism of the capital market of the country, in general the financial policies followed by the individual units are the financial policies of the industry as a whole When the saturation point is reached the scope for further expansion of the industry becomes restricted Only a small number of new units is promoted in such old industries Such units might have to rely more on ownership capital

The competitive position of a unit

The competitive position of a particular unit within a particular industry—In the present day world the individual companies usually operate under conditions usually called imperfect competition This situation implies a certain degree of monopoly and a certain degree of competition In an industry the things of the same type produced by different units are not identical and indistinguishable from each other Although they meet the same demand, to the extent that they are distinguishable from each other they are different products Certain producers by advertising and other means are able to develop a slightly preferential position for their goods and to this extent they are able to enjoy a certain element of monopoly in the midst of general competitive situation The dhoties produced by Arvind and Finlay and the jeans produced by Buckingham mills command a certain amount of preference in the textile market The products of Hindustan Levers enjoy a similar preference in the Vanaspati market A similar situation does not exist in the sugar market A large number of factories are producing white sugar in India but no single unit commands any preference for its product So the degree of competition found in different industries is different Where the competition is more intense the element of uncertainty about the volume of sales and the amount of profit is

interest rates prevailing in the market at the time of financing, by the credit standing of the company in the market and the form and type of security chosen to be offered The choice of the form or type of security, in its turn, is dependent upon the comparative costs of alternative forms the degree of risk to the company involved in the use of various forms and the availability of finance During the last few decades the cost of debt finance has been lower in comparison to preference or equity finance Under such conditions debt financing may be chosen in spite of the risk it involves on account of its cheapness and availability Then again as between the short-term and long term debt the weaker companies may resort to short-term debt because it is cheaper and more readily available although it involves a potential threat to solvency on account of the recurring necessity of repayment and renewal In some of the industrially advanced countries the short-term bank-lending rates are lower than bond yields During such periods of low short-term rates there is a strong temptation to obtain funds on the basis of short maturities of low cost But it may be more prudent for average company managements to secure long-term finance on somewhat higher rates to safeguard themselves against still higher rates and paucity of funds later on The higher cost at this time may be justified as it assures a command over funds obtained now over a longer period For companies, having a strong financial position, it may be economical to pay a higher bank rate and wait for a future opportunity of financing on a lower yield debenture basis rather than to commit themselves over a longer period at a higher current rate on long-term debt securities A safe and conservative opinion, however, is that where there is a possibility of making choice, it is better to decide in favour of long term financing so as to be able to secure the benefit of the device of liquidating the obligation gradually and conveniently from funds set up for this purpose rather than be compelled to take resort to refinancing operations under uncertain and probable inconvenient conditions prevailing in the capital market in future

The preference shares carry with them a minimum obligation on behalf of the management to pay regularly the stipulated rate of return or to repay the principal Preference capital assumes more risk in comparison to the debt capital and as such normally costs more than the debt capital Large sized companies with a better credit standing are in a better position to sell preference shares in comparison to the companies of a smaller size During the period of the upswing of the business cycle, when business confidence is high, preference shares can be sold easily almost on debenture or bond yield basis The conditions are likely to be equally unfavourable during the period of difficult or unhealthy business conditions

In the case of the cost of equity capital a rough measure of cost is the relation of earnings to the price per share A correct measure, however, would be the relationship of future earnings to the price because a particular price is paid in the hope of expected future earnings But the future earnings may be over- or under-estimated and accordingly the relationship of current earnings to